CONGRESSIONAL REVIEW OF OCC PREEMPTION

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

JANUARY 28, 2004

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CONTENTS

Page

Hearing held on:
    January 28, 2004 1
Appendix:
    January 28, 2004 51

WITNESSES

WEDNESDAY, JANUARY 28, 2004

Belew, Joe, President, Consumer Bankers Association 42
Hammond, W. Lee, Board Member, AARP 43
Miller, Hon. Thomas J., Attorney General, State of Iowa, on behalf of the National Association of Attorneys General 15
Shelton, Hilary O., Director, Washington Bureau of the National Association for the Advancement of Colored People 45
Taylor, Diana L., New York Superintendent of Banks, on behalf of the Conference of State Bank Supervisors 17
Taylor, John, President and CEO, National Community Reinvestment Coalition 37
Thomas, Karen M., Director of Regulatory Affairs, Independent Community Bankers of America 40
Williams, Hon. Julie L., First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency 13
Yingling, Edward L., Executive Vice President, American Bankers Association 36

APPENDIX

Prepared statements:
    Kelly, Hon. Sue W. 52
    Oxley, Hon. Michael G. 54
    LaTourette, Hon. Steven C. 56
    Belew, Joe 58
    Hammond, W. Lee 73
    Miller, Hon. Thomas J. 86
    Shelton, Hilary O. (with attachments) 136
    Taylor, Diana L. 145
    Taylor, John 167
    Thomas, Karen M. 181
    Williams, Hon. Julie L. 195
    Yingling, Edward L. 214

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Gutierrez, Hon. Luis V.:
    Transcript of voice mail message received by Assistant Attorney General Mark Fleischer, January 7, 2003 232
Kelly, Hon. Sue and Guiterrez, Hon. Luis V.:
    Letter to GAO, April 1, 2004 233
    Letter to OCC, February 27, 2004, with their response 235
Kelly, Hon. Sue W.:
    Letters from various Members to Hon. John D. Hawke, Jr. 274
Taylor, John:
    NCRC Report, "The Broken Credit System" 290
    NCRC statement to OCC, September 25, 2003 347

	Page
Financial Services Roundtable, prepared statement	354
National Association of Attorneys General letter of OCC, October 6, 2003	367
National Association of Realtors, prepared statement	386
Wisconsin, Department of Financial Institutions, prepared statement	401

CONGRESSIONAL REVIEW OF OCC PREEMPTION

Wednesday, January 28, 2004

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:10 a.m., in Room 2128, Rayburn House Office Building, Hon. Sue Kelly [chairwoman of the subcommittee] presiding.

Present: Representatives Kelly, Garrett, Murphy, Oxley (ex officio), Barrett, Gutierrez, Inslee, Moore, Crowley, Maloney, Davis, and Frank. Also present was Mr. Ney

Chairwoman KELLY. [Presiding.] The Subcommittee on Oversight and Investigations will come to order.

Today the Subcommittee on Oversight and Investigations will conduct a review of two regulations that were finalized earlier this month by the Office of the Comptroller of the Currency. The regulations preempt State laws that currently apply to national banks and they restrict the authority of States and other agencies to examine or take actions against these entities. When they take effect on February 12, these regulations will effectively prevent a State from determining and enforcing its own banking laws.

Preemption of any State law is an extremely serious issue, with significant consequences for all Americans. The preemption of state banking regulation is even more serious because it has critical implications for consumer protections and the overall dual banking system which has served our country very well for decades. A decision of this magnitude requires considerable review by Congress to ensure that consumer protections are not being undermined and that the balance of the dual banking system is not disrupted. The OCC is tasked with interpreting congressional intent. In terms of these regulations, the intent of Congress is unclear.

The correspondence of several dozen Members of Congress from both sides of the aisle, however, demonstrates that Congress has many unanswered questions and concerns that need to be thoroughly reviewed before these changes are implemented. As the Chairwoman of the Financial Services Committee on Oversight and Investigations, I wrote to the OCC on December 1, 2003 asking the agency to delay the rules being finalized until Congress can hold hearings to review the agency's proposal and signal our intent. The OCC went ahead and finalized the rules without the necessary review. This was an action that I believe demonstrates a lack of respect for Congress and for this committee.

I am concerned that an agency tasked with interpreting the laws passed by Congress has strayed from its obligation to protect consumers. The OCC is supposed to be an independent agency. Its actions have led many of us to question whether or not they are also independent of the people's best interests. Unfortunately, this is not the first time that Congress has had difficulty working with the OCC, which indicates to me that there may be a larger systemic problem at that agency. Congress must and will take all necessary steps to ensure that the interests of the American people come first, even if it means a culture of change at the OCC.

The American people expect and deserve real leadership and accountability when an action which could potentially jeopardize crucial consumer protections goes forward. We are going to see to it that consumers get these assurances. It may have been the agency's decision to move forward without congressional review, but this committee's ability to protect consumers and to provide oversight will not be inhibited.

We will begin the investigation today, and it will continue until all questions are answered, and the committee determines an appropriate course of action. I have personally spoken with Comptroller Hawke and he has promised to testify before the committee when he returns from his medical leave. I have also asked Mr. Hawke to take the necessary steps to delay the implementation of these regulations until we complete our review. The Comptroller of the Currency is a Presidential appointed and Senate confirmed position, and these regulations should not be implemented without a direct explanation from the Comptroller himself.

This request presents the OCC with a tremendous opportunity to display to Congress and the consumers that this is an agency that takes the review seriously and is willing to address concerns with the regulations. In terms of the substance of these new regulations, my colleagues and I hope many questions can be answered today. I recognize that we live in a different world today, with an advanced financial services sector in which companies utilize technology and other resources to offer better and less costly products and services.

In principle, I also understand that there is need for more uniformity in regulation, and that we need to investigate whether a patchwork of laws may impede progress that is beneficial to consumers. In fact, this committee has held several hearings on reforms in insurance and securities regulation, with the intent that changes could be made by Congress through a legislative process. However, for a regulator to single-handedly preempt a State's ability to both determine and enforce laws without public debate or explicit direction from Congress is not only troublesome, but I believe it is careless. The American people deserve better. The American people deserve a voice in these decisions.

I am certain that many Members have questions today specifically on the issue of predatory lending. While this is one of the significant laws preempted, I caution that we not focus solely on this issue. Given the overreaching nature of these regulations, which appears to be much larger than just this one issue, I hope my colleagues in the Subcommittee on Housing and Financial Institutions

will continue their own investigations into predatory lending to address these specific concerns.

I want to remind Members this hearing is to collect facts to see if Congress needs to further clarify its intent to the OCC. As usual, the committee's 5-minute rule will be observed, and I ask staff to remind their Members of that if the Members are not here at this time. I would like to thank the witnesses for their attendance here today, and I look forward to working with you on these important issues.

The Chair notes the presence of Members of the full committee and welcomes all of you. I ask unanimous consent that all Members present today will have their statements, questions and the answers to those questions included in the record. Without objection, so ordered.

One of our first opening statements will come from my Ranking Member, Mr. Gutierrez.

[The prepared statement of Hon. Sue W. Kelly can be found on page 52 in the appendix.]

Mr. GUTIERREZ. Thank you very much, Madam Chair, for holding this timely hearing. These rules were issued on January 7 before we returned from recess. I commend you for arranging this meeting as quickly as you have.

I share a number of your procedural and substantive concerns about the OCC's proposed rules. As most of us are aware, Federal preemption occurs in one of three ways: Congress expressly preempts State law; Congress establishes a framework of regulation that occupies the field and leaves no room for much state action or any state action; or State law conflicts with Federal law. For as long as I have served here, and for sometime before that, it has been clearly the intent of Congress that State laws should apply to national banks in a number of areas, including consumer protection and fair lending, unless Congress expressly preempts those State laws.

Congress never intended the OCC to preempt the field of lending. In response to the OCC's overreaching in the past, the Riegle-Neal interstate banking law sought to clarify the limits of the OCC's authority and establish certain notice and comment procedures to be observed on the rare occasion when State laws impede the ability of national banks to conduct the business assigned to them by Congress. The OCC's standard of "obstruct, impair or condition," articulated in this rule is a major departure from congressional intent and established precedent, inconsistent with some of the OCC's previously articulated preemption positions and at the very least of fair-weather Federalism.

State legislatures have long functioned as incubators of innovation because they have been able to act quickly and creatively to respond to changes locally in the marketplace. Frequently, their excellent product proves its merit beyond its borders and becomes the basis for a change in Federal law. I am deeply troubled that the OCC's action could stifle this innovation. In other instances, State law improves upon Federal laws. In fact, a number of laws written by this committee indicate that State laws are not inconsistent with Federal laws if they provide greater protection to consumers. If the consumer does better at a State level, this committee and

this Congress on many occasions, as many of us have articulated in many times past, that those are the laws.

I am particularly concerned about the area of predatory lending and its disproportionate effect on minorities. As you are likely aware, two recent studies showed that African Americans were four times more likely to receive a subprime loan, and Latinos 2.2 times more likely than their white counterparts. That disparity between whites and minority actually grows at upper-income levels. There is currently only minimal Federal protection in terms of predatory lending, minimal, at the Federal level, but the primary protectors of the consumer, the States, have enacted a number of laws in the area to regulate and curtail many predatory practices. These State laws should not be preempted unless and until Congress enacts a comprehensive Federal law that provides greater protection to consumers.

The OCC's mission and primary enforcement goal is to ensure the safety and the soundness of financial institutions under its purview, which can directly conflict with the goal of consumer protection because unconscionably high points and fees and inadequate and deceptive disclosures and unfair practices can be extremely profitable to banks. Furthermore, the OCC's wholesale preemption of state consumer protection statutes will deprive consumers of the private rights of action currently available to them.

I want to thank you again, Madam Chair, for calling this hearing because I think it is going to be very, very critical to how we proceed with protections for our consumers across this country. Thank you so much.

Chairwoman KELLY. Thank you very much, Mr. Gutierrez.

We go now to the chairman of the full committee, Mr. Oxley.

Mr. OXLEY. I want to thank you, Madam Chairwoman, for holding the first congressional oversight hearing on the OCC's recently issued regulations setting forth standards for determining when State laws can be applied to the operations of national banks, an ongoing issue, all of us I think would agree. Our dual system of national and state bank chartering is a unique feature of the U.S. financial marketplace and has served the American economy and American consumers well for almost 200 years. Since the inception of the dual banking system, tension has periodically flared between Federal and State authorities over the proper allocation of responsibility for overseeing the activities of national banks.

The regulations issued in final form by the Comptroller earlier this month, after a period for notice and comment, are the latest chapter in that long-running debate. While most of the attention in the media and elsewhere is focused on OCC's preemption of predatory lending laws that an increasing number of States and municipalities have enacted in recent years, the regulations are in fact much broader in scope and raise issues that go to the heart of the dual banking system, including the following:

Should institutions that are chartered by the Federal government and operate on a nationwide basis be required to comply with laws passed by state or local governments that address core bank functions such as lending and deposit-taking?

Should the authority to enforce Federal and State laws against national banks reside exclusively with the OCC, except as other-

wise provided by Federal law, or do state attorneys general and other state agencies have a role to play?

Does the application of uniform Federal standards to lending and deposit-taking and the centralization of authority for enforcing those standards promote the safety and soundness of national banks and yield benefits for their customers?

In my view, the OCC regulations represent a thoughtful attempt to codify and harmonize past legal precedents—and there are many—and regulatory guidance into a coherent framework for resolving conflicts between Federal and State laws as they apply to national banks. The regulations largely conform the preemption standards applicable to national banks to those that have long been applied to Federally chartered thrifts by the Office of Thrift Supervision and to Federal credit unions by the National Credit Union Administration.

With respect to the charge that the OCC's regulations leave customers of national banks exposed to abusive lending practices, it should be noted that there is a decided lack of evidence that national banks have engaged in such practices, which tend to be centered instead in non-Federally regulated mortgage and finance companies that remain fully subject to state and local anti-predatory lending laws. Moreover, for those national banks that do engage in abusive or unscrupulous tactics, the OCC's regulations contain new standards prohibiting institutions from making loans based predominantly on the foreclosure value of the collateral and without regard to the borrower's ability to repay, and from engaging in unfair and deceptive trade practices as defined by the FTC.

We will hear from opponents of the OCC's regulations at today's hearing who question the agency's commitment to enforcing its new anti-predatory lending standards and argue that consumers are better served by a regime in which national banks must answer to both Federal and State authorities.

In closing, let me again commend Chairwoman Kelly for tackling this difficult issue and for rigorously asserting this committee's oversight prerogatives to ensure that the Federal agencies within our jurisdiction act in the public interest. Let me also welcome all of our witnesses to today's hearing, particularly OCC Chief Counsel Julie Williams, who has been here before, to pinch-hit for Comptroller Jerry Hawke as he prepares to undergo surgery later this week in New York. We wish him a speedy recovery and look forward to continuing this committee's dialogue with him on this and other issues of concern upon his return to duty in March.

I yield back the balance of my time.

[The prepared statement of Hon. Michael G. Oxley can be found on page 54 in the appendix.]

Chairwoman KELLY. Thank you, Mr. Chairman.

We go now to our Ranking Member, Mr. Frank.

Mr. FRANK. Madam Chair, your initiative in calling this hearing is something that we all very much appreciate. This is an extremely important issue, so important that I must say that there is both a procedural and a substantive argument here. The procedural one is that this is a very far-reaching change in the way in which the banking system has been run, and the Comptroller acknowledges this. I do not think it is appropriate for this to be done

entirely by an executive fiat, particularly an executive for whom I have a great deal of respect, Mr. Hawke, and his operation, but who even as an executive is somewhat insulated from the process. The Comptroller is a somewhat protected individual.

I say that because I do not think we should be arguing primarily legally here. This will go to court. But just because something is legal does not make it right. There are a lot of legal things to do that are kind of stupid. I would not say this one was stupid, but I think it is counter-productive. What we have here is a fundamental policy question about how banking authority ought to be divided and I think we in Congress ought to deal with it.

Now, I want to also note that many of us on our side, and I believe some on the other side as well, are very much opposed to this, not because of any hostility to the notion of national banking. Overwhelmingly, the Members of the committee on this side of the aisle supported within a month or two legislation that extended preemption in the field of credit. We are not reflexively against preemption. What we felt then was that there was a national issue there in terms of credit reporting. People do not apply for credit from their neighborhood. Credit is given nationally.

Real estate lending, on the other hand, is a more local operation. What I believe we should be doing is a policy area by policy area decision about preemption. I think there was a strong argument for preemption with regard to the reporting of credit. I do not believe it is with regard to real estate lending. One of the arguments we give as well, if Georgia or this state or that state passes a law, then the rating agencies will be mad at them and they will not be able to participate in the secondary market. Why can't they make that choice under our constitutional system? It does not hurt me in Massachusetts. If Georgia chooses to draw the line on this side rather than that side, why is that inherently violative?

I do agree with regard to credit. Some national laws had to be there. But with regard to real estate, I am always told by people in the business, location, location, location. That is local. It seems to me there is a strong argument there. The premise ought to be that we leave to the States what they can do, unless there is good reason to the contrary.

Beyond that, I am particularly disturbed, and I would hope Ms. Williams will be able to address this. I may not be able to stay because I have a meeting of the homeland security committee, and that is a problem when we only meet a couple of days a week. You have to be in about nine places at once. The part of it that particularly bothers me is the assumption of enforcement powers even where it is conceded that the State has the right to make laws. Let me say in particular, I note, and I was glad to see Ms. Williams point out that any discrimination laws will be valid; that States can pass any discrimination laws that could presumably be tougher than the Federal laws and they will still be valid, but the State will have no power to enforce those.

Now, what we have here, it seems to me, is an assertion by the Comptroller of greatly increased enforcement powers. I hope Ms. Williams will tell us what new enforcement resources you are bringing to bear on this. You are knocking out of the box 50 States which have their own enforcement mechanisms, and you would

take on the enforcement. We are not talking now about some of the argument about whether or not the State laws apply. But in those areas where you concede that State laws apply, including discrimination, which is something, frankly, which seems to me under-enforced in this country, discrimination in lending, you are now saying to the States, you can pass the law, but we will enforce it.

Frankly, I do not think we at the Federal level have the capacity to do that. I see no sign that anybody has taken that into account. I think what we are going to see as a result of this is a diminution of enforcement even in those areas where it is conceded that the States have power.

So I look forward to our continuing to deal with this, and I thank the Chair.

Chairwoman KELLY. Thank you very much, Mr. Frank.

Mr. Garrett?

Mr. GARRETT. Thank you, Madam Chair.

Just very briefly, first of all let me thank you for holding this hearing. It rises to the level of importance on the two areas, and I join with my colleagues on the other side of the aisle inasmuch not only is it a question that I am interested in on the merit side of the equation, but the fundamental procedural aspect as to exactly how we get to this where the fundamental States rights issues are addressed through an agency's approach as opposed to a directive coming directly from Congress.

At the outset, I am a little bit troubled by the Chairlady's opening comments with regard to the lack of responsiveness to the inquiries that you have made of the OCC. I would have hoped that you would have received a better response than you did. Secondly, I will be interested to learn as we go forward with the testimony with regard to the extent of what we going to hear as far as the authority that the OCC is now establishing. I have been told by folks who are here a lot longer than I, so that is why I will look to you for the information, that the OCC has a history of trying to over-extend its authority in certain areas, and specifically reaching out in the area of insurance regulation. So one of the questions or interesting areas I would like to know and hear about is whether the OCC will be trying to extend through the regulations, or have any impact whatsoever with regard to the State regulation thereafter of national banks with regard to their insurance activities.

Additionally, and maybe this goes back to the first issue of the lack of responsiveness that you cited, was what is it that prompted this activity now. We know all about the activity in Georgia, of course. I come from the great State of New Jersey and we know what is going on there. I am told that the OCC in the past has had more of an incremental approach to dealing with these types of problems. Here, however, if I am understanding you all correctly, it is a much broader and blanket approach. I could understand that if I was reading in the paper what was happening in Georgia and New Jersey, what is happening everyplace overnight in that there was immediacy to the problem, but I just do not see it, and why you are changing from an incremental approach of dealing on a case-by-case basis.

Finally, I am just curious also to look into the aspect of the impact it has on the State regulation of the State things vis-a-vis the

national bank, and is this an effort by the OCC in a way simply to say that we are going to try to lure even more so the States over to the national charters so that at the end of the day when I go back to my state legislators, their responsibility in the entire field of banking and insurance and consumer protections has been relegated to absolutely nothing because it has always been lured out and taken away from them.

Thank you, Madam Chair.

Chairwoman KELLY. Thank you very much, Mr. Garrett.

Ms. Maloney?

Mrs. MALONEY. First of all, thank you, Madam Chair. I would like to take the liberty of welcoming one of my constituents from the great State of New York and New York City, Superintendent Taylor; and also welcome Attorney General Miller and Comptroller Williams.

Just very briefly, I believe the preemption of state banking supervisors, attorneys general, legislatures, chief executives and voters is a very dangerous blow to both the dual banking system and our country's Federalist tradition. For 150 years, this country has been well served by the dual banking system. Today where technology allows a single national bank to serve our constituents from coast to coast, it is even more important to retain a role for localities to have some input into the large institutions that dominate financial services.

The OCC argues that its actions are merely an incremental step forward, codifying judicial decisions that were decided on existing statutes. While I have great respect for the Comptroller and I wish him very well in his treatment and his recovery, and I have great respect for his staff, I think they are understating the magnitude of their actions.

My fear for the future of the dual banking system is based on two points. First, States play an incredibly important role in the regulatory framework. Across the country, hundreds of state employees work on consumer protection issues. They live in our home States and have much closer ties to the community than is possible for a national regulator no matter how capable. State regulators and attorneys general have proven records of service in protecting consumers.

Secondly, in the eyes of the industry, the national bank charter is greatly enhanced by the OCC's actions. I certainly support the national charter, but I am concerned about the ramifications of such a major change without congressional hearings and approval. It is my understanding that more than a dozen of large national bank operating subsidiaries are planning to leave the State system once the regulations go into effect on February 12. This trend alone could be the beginning of a stampede and it demonstrates the magnitude of the OCC's regulatory ruling.

While I oppose the decision to preempt the States, I want to add that the OCC does a very good job regulating the national banks for which it is responsible. I have always enjoyed working with the agency and I appreciate the fact that national banks are not the practitioners of widespread predatory lending. On this committee, we are often asked to balance the efficiency required for national markets to operate seamlessly, versus the rights of States and cit-

ies to enact and enforce local laws. Last year, I worked closely with the Ranking Member of this committee and in a bipartisan manner to pass FCRA reauthorization preempting State laws governing credit reporting. I was convinced that on credit that we needed a uniform national standard. Here, I believe the national regulator has gone too far.

Thank you.

Chairwoman KELLY. Thank you very much, Ms. Maloney.

Mr. Murphy, do you have an opening statement?

Mr. MURPHY. No.

Chairwoman KELLY. Mr. Crowley?

Mr. CROWLEY. Thank you, Madam Chair.

I want to thank my New York colleague, Chairwoman Sue Kelly, and Ranking Member Luis Gutierrez for conducting this important hearing today on OCC and their recent regulations. I would also like to thank one of our witnesses as well, who is not a constituent of mine, but certainly a well-known individual in our city and our State, Diana Taylor, who is the New York State Supervisor of Banking. She is a pro, and someone I have been pleased to get to know more closely over the last few years. Welcome to all our panelists today.

The issue of today's hearing is bigger than that of national versus state-chartered banks, in my opinion, or the presumed powers of the OCC. The real question here deals with ensuring the greatest protections of all American banking consumers with respect to stopping abusive lending practices. While I welcome the approach undertaken by the OCC of creating one uniform Federal standard for all national banks and their operating subsidiaries with respect to predatory lending as a way of creating a level playing field for all national banking customers and consumers, I also do believe the regulations they are putting in place on this front are weak at best.

Our constituents have no idea where their bank is chartered and, quite frankly, they really do not care. But they do care about protecting their money and their investments and keeping access to capital free and flowing. The establishment of this national, albeit weak standard by OCC drives home the need for real action by Congress this year to address predatory lending with a strong national law that governs lending at all financial institutions and their operating subsidiaries regardless of where they are chartered. These are issues we need to address in this Congress.

Hopefully, this action by OCC will lead my colleagues to work together in a bipartisan way to create a new uniform Federal standard in lending practices that crushes predatory lending, but allows subprime to continue to thrive and put money into the hands of people that need it and to communities that I quite frankly represent as well, minority communities that my good friend from Chicago so ably has been defending.

I look forward to today's hearing and hope for a good back and forth volley on questions and answers, not only to the issue of OCC regulations, but more importantly on the larger issue of the need for congressional action to address lending abuses this year, to protect all banking consumers regardless of where their bank is chartered. Additionally, at this hearing, because it is so important, it

is my hope that if time permits we will be able to ask additional questions.

I once again want to thank the Chair and the Ranking Member for calling this hearing.

Chairwoman KELLY. Thank you very much, Mr. Crowley.

Mr. Barrett has indicated he does not have an opening statement, so I am going directly to Mr. Ney.

Mr. NEY. Thank you, Madam Chairwoman. I appreciate you and Ranking Member Gutierrez for holding this very important hearing.

There can be no doubt about the importance of both the housing markets to our nation's economy and the importance of the dual banking system to our nation's financial markets. I want to applaud the hard work of the Comptroller of the Currency in putting together what I think is both a fair and necessary rule for how state and local abuse of lending laws affect national banks. I think that this rule highlights the evolving nature of our nation's housing finance market.

Twenty years ago when I was in the State legislature, I would have never said that I support a national standard for mortgage lending, but the world has changed since I was in a State legislature, and since this issue is being addressed here. Now we have an intensely competitive marketplace with lenders, frankly, from all over the nation competing to make loans to consumers. Consumers can go on the Internet and apply for loans, or they can call a 1-800 number to apply for credit. When they are doing this, they do not worry about where that lender is located; just that they are getting the best rate and terms possible. This environment has ensured that there is a strong supply of credit at very affordable prices.

Furthermore, many of today's loans are securitized and sold in the secondary market all over the world. Over 30 percent of mortgage-backed securities are now held by foreign investors. Unfortunately, a growing patchwork of state and local laws are threatening the viability of this national marketplace. I do not have time today, but I can give you countless examples, including in our own State of Ohio. A lot of times, those have not benefited, frankly, are the consumers. They threaten to restrict the availability of credit and raise the cost of borrowing for consumers across the nation.

In the past few years, we have seen how important the housing market has been to our nation's economy. The strength of the housing market made the past recession one of the least severe in our nation's history. The growing patchwork of state and local laws could severely damage our nation's economy and weaken the recovery that we have been experiencing. Comptroller Hawke recognized this and took decisive action to make it clear that Congress created the national bank charter with the intention of creating a national bank charter to provide a uniform banking system of regulation for national banks.

The OCC rule published earlier this year makes it clear that our credit markets need a uniform system of regulation. It also makes it clear that we cannot tolerate bad actors in the mortgage business, and we shouldn't. The OCC also has acknowledged that some lenders engage in abusive credit practices and that those practices

should be outlawed. While national banks have rarely been found to be engaged in abusive practices, the regulation still includes an important new anti-predatory lending standard. This standard prevents any national bank from making a loan based upon the foreclosure value of the collateral associated with that loan. This means, of course, that a national bank must thoroughly assess a borrower's ability to repay the loan before making it. It also means that national banks cannot unfairly place a borrower's home under the threat of foreclosure. This is good.

While this regulation is a good first step, it only applies to national banks and leaves many institutions untouched, which comes to my punchline, if you want to call it that. I have a predatory lending bill. We need to protect consumers. I am working bipartisanly with Members of the Financial Services Committee also to look at counseling and many, many other important issues. I think it is time for a national standard. I think this rule in no way conflicts with what we are trying to do. In fact, I think a follow-up with a predatory lending bill that is aimed at protecting consumers and still having subprime loans available is going to close that loophole because this will apply only, of course, to certain banks.

With that, I want to thank you, Madam Chair.

Chairwoman KELLY. Thank you, Mr. Ney.

Mr. Moore?

Mr. MOORE. Thank you, Madam Chair and Ranking Member Gutierrez. Thank you for holding this oversight hearing on the OCC's state banking oversight preemption regulations.

Our nation's dual banking system has served the country well for over 140 years, but there is an inherent tension in the dual banking system and it is appropriate that this subcommittee examine the impact of these regulations on both the banking industry, and more importantly, the consumers of the banking products and services.

It appears that some of the issues raised in our debate over the Fair Credit Reporting Act may be relevant here. At the end of last year, this Congress permanently extended the Federal preemption provisions in the Fair Credit Reporting Act after concluding, on a bipartisan basis, that uniform national standards were essential for our national credit system. In that case, we realized that uniform national standards helped consumers because they expanded the availability of credit and improved the efficiency of our financial services system.

In this case, I suspect that similar arguments will be made in support of the regulations issued by the OCC. Like FCRA, it will be suggested that the OCC's actions permit national banks to offer products and services to consumers on a consistent basis, regardless of where the consumer resides. I expect the OCC and the industry to suggest that these rules will allow banks to operate more efficiently and effectively, and these efficiencies can be passed along to the consumer in the form of better products and services at lower prices.

On the other hand, I know that some consumer groups are concerned about the impact of the regulations on consumers and the State banking regulators, including the Kansas Banking Commis-

sioner, are concerned about the impact of the regulations on their agencies's ability to service the public interest. I practiced law for 28 years before I came to Congress and I learned that there are at least two sides to every story most of the time, sometimes many more. Often, the truth, and sometimes even the best policy, is not found at either extreme but somewhere in the middle. For this reason, I look forward to the testimony of the witnesses at this timely hearing. I hope that they will be able to speak to the similarities or differences between what we did with FCRA and what the proposal is by the OCC in these regulations.

Thank you.

Chairwoman KELLY. Thank you very much, Mr. Moore.

Mr. Davis?

Mr. DAVIS. Thank you, Madam Chairwoman. Let me thank you and the Ranking Member for convening this hearing. Given the time, I will try to be as brief as I can and just make a few observations at the outset.

One of the things that really lingers in my mind from my first year in Congress, the first part of the 108th, was an observation that someone made from one of those chairs about 3 months ago. It involves the fact that the frequency of subprime lending is frankly twice as high in the affluent African American community as it is in the non-affluent Caucasian community. We tried to talk about why that exists. I am not sure that we ever got a good solid answer that day, but it strikes me that that ought to be somewhere near the backdrop of this whole analysis.

I agree with my very able colleague from Kansas that there are some superficial parallels with the debate over FCRA and I am certainly sensitive to the idea of a nationalized standard because of the predictability benefits, or the gains in predictability. At the same time, I have yet, in all the many times I have come to this room, to hear a really good explanation of why predatory lending has taken on, frankly, a racially discriminatory character. On its face, there is no reason to think that it would, but for whatever reason, again, the subprime rate is twice as high in the affluent black community.

I am very interested in hearing your perspective today on another question, which is exactly how the patchwork is going to work between state and nationally chartered banks. On its face, I can understand why the States have an interest in enforcing laws against banks that have chosen to take out a State charter on their own. I have some vague memory from civil procedure of the whole purposeful availment theory, and I am certainly interested in hearing your perspective on that.

I hope that the backdrop that we have, as Chairman Ney said, is to try to find some way to, if we can, have a strong standard across this country, but to make sure that we are also addressing some very obvious mortgage practices that certainly do not need to a strong economic foundation, and I think are certainly reprehensible to a lot of people on this committee.

I will yield back my time, Madam Chairwoman.

Chairwoman KELLY. Thank you very much.

If there are no other opening statements, then the Chair will continue on here with our first panel introductions. On this first

panel today, I am pleased to have with us three excellent witnesses. First is the Honorable Julie L. Williams. She is First Senior Deputy Comptroller and Chief Counsel representing the Office of the Comptroller of the Currency. Also with us is the Honorable Thomas J. Miller, Attorney General, State of Iowa, testifying on behalf of the National Association of Attorneys General. I discussed this issue with Attorney General Miller at another hearing last November. It is good to see you again today, Attorney General, and we do thank you for coming back.

And finally, I am honored to have the opportunity to introduce Ms. Diana L. Taylor. She is the New York Superintendent of Banking. She will be testifying on behalf of the Conference of State Bank Supervisors. There are many important issues that we are going to discuss today, but none more significant than protecting consumers, something Ms. Taylor takes very seriously as the head of the New York banking department.

I thank you all for your appearance today. I know that it was not easy to travel and plan to be here, so I appreciate your spending time with us this morning. Thank you very much. Without objection, your written statements will be made part of the record and you will be each recognized for 5 minutes. If you have not testified before, the box on the table in front of you has three lights. Red means stop. Yellow means you have 1 minute. Green, of course, means go.

So we are going to start with you. You may go first, Ms. Williams.

STATEMENT OF HON. JULIE L. WILLIAMS, FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Ms. WILLIAMS. Chairwoman Kelly, Ranking Member Gutierrez, Ranking Member Frank, and Members of the subcommittee, I appreciate the invitation to discuss the OCC's recently issued preemption rules. I will begin by describing what our new rules do and what they do not do. Then I will explain why we took the actions we did and why we acted when we did. Then I will address one of the misperceptions, one of many, unfortunately, that surround the new rules. There have been some rather extreme characterizations of these new rules, so let me begin by explaining exactly what they do.

The first regulation, I will call it the preemption rule, clarifies the extent to which national banks's lending, deposit-taking and other Federally authorized activities are subject to State laws. The rule provides that a State law does not apply to a national bank if the State law obstructs, impairs or conditions the bank's ability to exercise the power granted to it under Federal law by Congress, unless Congress has provided that the State law does apply. This approach reflects fundamental constitutional supremacy clause doctrine. The regulation carefully follows standards established by the U.S. Supreme Court.

Our rulemaking authority is based on several sources in Federal law. The types of State laws the rule preempts is substantially nearer those already preempted by the Office of Thrift Supervision

in its preemption regulations for Federally chartered savings associations.

It is also important to recognize what the OCC's preemption regulation does not change. It does not immunize national banks from complying with a host of State laws that form the infrastructure of doing the business of banking; contract law, tort law, public safety laws, generally applicable criminal law. It does not preempt anti-discrimination laws, nor, Mr. Frank's issue, enforcement of those laws. It does not change the allowable rates of interest a national bank may charge on a loan. It does not authorize any new national bank powers or activities, and it makes no changes to our existing rules governing the activities of operating subsidiaries.

Our second new regulation interprets a provision of the National Bank Act that grants the OCC exclusive authority to supervise, examine and regulate national banks. In this, what we call our visitorial powers rule. We clarify that the scope of the OCC's exclusive authority focuses on the content and conduct of the banking business that is authorized to national banks under Federal law. We also interpreted a portion of the statute that refers to powers of courts of justice as not grant to State officials any additional authority beyond what they might otherwise possess to examine, supervise or regulate the banking business of national banks. That is what we did.

The second point I want to address is why we took these actions and why we took them now. We have recently seen an unprecedented number and variety of state and local enactments intended to limit and control the ability of national banks to engage in banking activities that have been authorized for them by Congress. These state and local enactments prevent national banks from operating to the full extent lawful under their Federal charters. They also undermine the vitality of the dual banking system, which is predicated on distinctions between state and Federal bank powers and regulations.

These laws, many with laudable goals, also have real practical daily consequences. They have unsettled mortgage markets, reduced the availability of legitimate subprime loans to some consumers, increased regulatory burden, added operational costs, created unpredictable standards of operation, and uncertain risk exposures. My written statement discusses these issues in more detail.

The OCC's new rules were designed to supply urgently needed clarification of the standards applicable to national banks's activities and to restore predictability to their operations. Our process, and I am sensitive to the Chairwoman's comments here, was neither sudden nor secret. Our rules are based on existing law and we acted as the circumstances became compelling. In developing these rules over a period of many months, now dating back to approaching almost two years, we solicited comments from all concerned parties. We consulted widely with representatives of the financial industry, public interest groups, other regulatory agencies and State officials. From the very beginning of our consideration of these issues, we briefed House and Senate Members and their staffs on both sides of the aisle, and we made ourselves available to answer any and all questions.

The Chairwoman has expressed a concern about whether we waited for Congress to signal its intent. This was a long, broadly inclusive, open process that resulted in these regulations. To depart from my script here and on a personal note, I very much regret if the Chairwoman or Members of the committee feel that that process was inadequate. That was certainly not our intent.

Finally, let me address one of the misperceptions that has arisen around our rules, namely its impact on predatory lending. We have zero tolerance for unfair, deceptive, abusive or predatory lending. We know its tragic consequences. We rigorously supervise national banks and their lending subsidiaries and there is scant evidence that they are the source of the predatory lending problem in this country. Our track record demonstrates that we will act vigorously if problems arise.

Two new provisions that we included in our regulation will make it even less likely that predators will find refuge in any national bank. The regulation first provides that national banks may not make consumer loans based predominantly on the foreclosure or liquidation of a borrower's collateral. This will target the most egregious aspect of predatory lending, where a lender extends credit not based on a reasonable determination of a borrower's ability to repay, but on the lender's calculation of its ability to seize the borrower's accumulated equity in his or her home.

The regulation also recognizes that other practices are also associated with predatory lending. Some may not realize that the OCC does not have the authority under the Federal Trade Commission Act to adopt rules defining particular acts or practices as unfair or deceptive under the Act. However, we can take enforcement actions in specific cases where we find unfair or deceptive practices. Our new regulation therefore specifically provides that national banks shall not engage in unfair or deceptive practices within the meaning of section five of the FTC Act in connection with their lending activities.

In conclusion, Madam Chairwoman, we believe our new rules protect as well as benefit national bank customers. We believe they are entirely consistent with the fundamentals of the dual banking system, and with Congress's design of the national banking system. I thank you for this opportunity to testify. I will be happy to answer any questions the subcommittee may have. Thank you.

[The prepared statement of Julie L. Williams can be found on page 195 in the appendix.]

Chairwoman KELLY. Thank you, Ms. Williams.

Mr. Miller?

STATEMENT OF THOMAS J. MILLER, ATTORNEY GENERAL, STATE OF IOWA, ON BEHALF OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

Mr. MILLER. Thank you, Congresswoman Kelly and Members of the committee, for having this hearing. This is a very important hearing. I say so because of what is at stake. Let me outline what I believe is at stake.

The regulations that have been adopted are breathtaking in their effect on States, on banks, and most importantly on consumers. Let me explain why I say that. One regulation changes the thrust of

state preemption. It makes it much more expansive than traditionally has been interpreted by the courts and certainly has been discussed by this committee. One view of preemption is if there is a conflict between Federal law or Federal regulation with the State law, the State law, of course, has to yield. Sometimes the standard has been used whether there is a substantial impairment of the Federal purpose, the State law fails. But what is here is any condition that affects the ability of a national bank to fully exercise its authority, any condition, any condition on a national bank, small large, good or bad, just about any regulation can be a violation of the OCC rule and therefore be prohibited.

I talked to you a few months ago about the enormous success of the North Carolina statute on predatory lending. It would appear to be preempted, and just about any other form of consumer protection. The step that has been taken here is dramatically different than has been taken before and is overwhelming in effect.

If that is not enough, whatever remains of State law as it applies to national banks, state authorities cannot enforce it as a result of one of the other regulations. This almost boggles my mind about why you would strike a balance, especially an extreme balance, and then go further and say the State authorities cannot even enforce State law, whatever remains. This is truly significant. In addition, it should be seen in the context that if they are subsidiaries of national banks, all of this applies. So subsidiaries that we are used to dealing with all the time, mortgage companies, finance companies, they enjoy the same preemption both as to the law and as to the enforcement that the national bank does.

What are the consequences of this? I say they are very significant. They are most significant for consumers. To take the States out of any kind of consumer protection with national banks I think would be a terrible mistake. The States are the laboratories of democracy. The States are the foot soldiers. Real estate transactions are local in nature. What about a routine credit card complaint that we get all the time? Against a subsidiary of a national bank, under the scheme proposed by the OCC, all of those complaints have to go to Houston. You have to call Houston.

What about the expertise that has been developed by States in this area, predatory lending for instance? It is gone as to national banks. One of the effects is this look at the standard on predatory lending in the OCC regulations. The standard is making a loan to ultimately foreclosure upon. Well, as a standard that is a misunderstanding of what happens in predatory lending. Most of predatory lending is premised on people staying in the houses and paying and paying and paying. They miss the boat, not because they are not smart, they are brilliant, but because they are not experienced. They have not dealt with this.

To take the States out of consumer protection as to national banks just does not make any sense at all. Only 3 years ago did the OCC even discover consumer protection in terms of use of the FCC Act. It was ignored for 25 years. They do not have the expertise. They do not have the experience that we have.

What about Congress? I was here 2 1/2 months ago testifying about the preemption question in a predatory lending environment. What the OCC has done has made that day for you and for me and

the other witnesses meaningless. They have taken the authority away from the Congress. And the Congress, more so than the OCC, is able to deal with these questions. You are the experts. You have the experience in dealing with balancing interests of consumers and lenders, balancing the Federalism concerns of States and the Federal government, not the OCC.

This is a decision that cries out for Congress, not the OCC, to make the decision, particularly in light of one aspect of the environment, and that is there is enormous competition for banking charters between the OCC and the States. If you want a good idea of the competitive spirit, go read Comptroller Hawke's speech on September 9 of last year to Women in Housing and Finance. He is really engaged in competing with States for charters. To allow him in that competition environment to make these very important and extremely far-reaching decisions, rather than Congress, just does not make sense and it has enormous affect on States.

As I have said in another context, this is the kind of preemption where most State law is preempted, and then what is left, there is a preemption of state authority to enforce. It is a dagger in the heart of Federalism. It ignores the legitimate interest of States and the work that has been done by the banking superintendents and by the attorneys general and the rest. That is why I say this is an important hearing. This is your decision, not the decision of a single bureaucrat.

Thank you.

[The prepared statement of Hon. Thomas J. Miller can be found on page 86 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Miller.

Ms. Taylor?

STATEMENT OF DIANA TAYLOR, NEW YORK SUPERINTENDENT OF BANKING, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS.

Ms. TAYLOR. Thank you very much, Congresswoman Kelly and Congressman Gutierrez and Members of the subcommittee. I am Diana Taylor, Superintendent of Banks of the State of New York. I am here today on behalf of the Conference of State Bank Supervisors. Thank you for inviting us to discuss our concerns about the Comptroller of the Currency's recent preemption of state consumer protection laws and enforcement authority.

From the start, I want to say that our system of financial regulation is confusing. But remember, we have the strongest financial system in the world. We have a virtual alphabet soup of rules, regulations and regulators that oversee banks operating in States, across state lines, internationally, and in ways and in businesses they have never operated in before, that were not even contemplated 10 or 20 years ago.

The situation we find ourselves in sitting here today is an outgrowth of a changing industry, and changing technology has allowed banks to conduct business in ways and areas they never could before. It is confusing, but this is a good thing. It is competition and capitalism at its best. Banking law has changed. Glass-Steagall has been changed. We have Gramm-Leach-Bliley and Riegle-Neal.

Chairwoman KELLY. Ms. Taylor, I am sorry to interrupt you, and we will give you the extra time. It is difficult for some people to hear you. Is it possible for you to pull those microphones a little more closely and perhaps raise your voice a bit?

Ms. TAYLOR. I apologize. I have never done this before, and I am also finding that 5 minutes is a very short period.

Chairwoman KELLY. Pick up where you were. I know it is tough, but we will give you the extra time. Don't worry about the time. We are here to hear what you have to say, but we want to hear it.

Ms. TAYLOR. Okay. Can you hear me now? Great. Okay.

From the start, I want to say that our system of financial regulation is confusing, but remember we have the strongest financial system in the world. We have an alphabet soup of rules, regulations and regulators that oversee banks operating in States, across state lines, internationally and in ways and in businesses they have never operated in before. The situation we find ourselves in sitting here today is an outgrowth of a changing industry and changing technology, which has allowed banks to conduct business in ways and in areas that they never could have before, never even contemplated before. It is confusing, but it is good. It is competition and capitalism at its best.

Banking law has changed. Glass-Steagall has changed. We have the Gramm-Leach-Bliley and Riegle-Neal now. Unfortunately, regulation has not always evolved at the same rate as the financial industry. We need to fix that. We have under-regulation. We have overlapping regulation and we have complete lack of regulation in some areas. But we need to fix this in a way where everyone has input, not just the constituencies of one agency, the OCC.

What brings us here today is neither helpful nor part of the solution. The Comptroller of the Currency has promulgated a series of regulations clarifying rules that they claim are already in effect. They have preempted lending and deposit laws for national banks. They have exempted them from the enforcement of any consumer protection laws by any entity other than itself, and they have granted operating subsidiaries the same preemption rights and visitorial immunity as the parent banks.

This means that a national bank and its operating subsidiaries no longer have to obey state consumer protection laws and no one other than the OCC has the right to go into a nationally chartered bank or, importantly, its operating subsidiaries to enforce any of these laws.

If all of this seems confusing to us, put yourself in the shoes of the consumer. Who here knows whether the bank you use yourself is a thrift chartered by the OTS, a national bank, or a State-chartered bank? I have been asking this question of financially sophisticated people in the financial capital of the world, New York, this question on a regular basis over the last few weeks, and I have to admit the result is decidedly mixed. Most people do not have any idea what charter their bank uses. Imagine a consumer going in for a loan.

If they go to a State-chartered bank, they enjoy all the protections that State laws can give. If, however, they go to a national bank, they lose all those protections. Rather, what they are due in

the way of protection is limited to the view of a single entity and the opinion of a Comptroller who is accountable to no one but himself to determine if that consumer has been wronged and further if that consumer has any remedy.

If there is a problem at that national bank, the consumer may be out of luck. State regulators and attorneys general can no longer investigate consumer complaints against national banks and their operating subsidiaries. We have to tell our citizens to call the OCC and hope that the OCC will take care of the problem. Two consumers with identical facts who go to two different banks with different charters will be protected to different standards.

The Comptroller insists that national banks do not engage in predatory lending. To that point, I urge you to look at my written testimony. You will read some horrifying stories there. Here are some other things that the OCC wants you to believe: one, that the new rules are no big deal; they do not really change a thing, and merely do what Congress and the Supreme Court intended all along; two, that you should pay no mind to the erosion of the dual banking system which these new rules will foster; three, that you should not worry that national banks that hold over 55 percent of all banking assets in the United States can now ignore virtually all state consumer protection laws and devices, including the rights of state attorneys general to bring actions for deceptive practices; and four, that the OCC has standards that they hold their banks to in order to prevent any predatory or deceptive practices. But look at those standards, and that should give you pause. The OCC prohibits lending based predominantly on the value of the borrower's home and it prevents or prohibits deceptive practices. There is nothing in there that is more specific than that.

Conversely, State laws such as New York State's law, give guidance as to what is unaffordable. We mandate that income be verified. We prohibit flipping and equity stripping and we proscribe the financing of single-premium credit insurance, which is an extraordinarily abusive product when it is financed. You should be concerned. Congress and only Congress has the authority to fundamentally change the rules. If Congress intended that States should have no say over what banks do in their respective States, then it is up to Congress to say so.

The last time Congress spoke, it clearly reaffirmed that state consumer protection laws apply to all banks, not just state-chartered banks. Please carefully consider whether you still believe the dual banking system is worth preserving. If the answer is yes, and I believe that that is the correct answer, then I urge you, do not allow the Comptroller's rules to stand.

I believe the U.S. banking system is as strong as it is today because of the dual banking system, in large part. We have avoided the trap of one monopolistic regulator up until now. It is not a perfect system. It needs change, but we need to change it only after due deliberation and consideration. Like Churchill said about democracy, it is the worst system, except for all the other ones. I do not doubt the sincerity of the OCC's belief that it can handle all consumer banking issues nationwide alone, without help from anyone, but I believe they are wrong. State banking agencies and at-

torneys general are valuable allies, not adversaries of the OCC in the fight to protect consumers.

Preemption traditionally involves a Federal law supplanting a conflicting State law, which the Attorney General said. Here, in the absence of a conflicting Federal law, the OCC seeks to brush away all State laws, all state consumer protection laws, supervision and enforcement because they impose conditions on the conduct of national banks and their subsidiaries. The result is an entire industry that is now exempt from compliance with state consumer protection statues and bound to good behavior by the slim tether of nebulous regulation. It is not only consumer protection that concerns us.

Chairwoman KELLY. Ms. Taylor, I am sorry but I am going to have to ask you to summarize quickly please.

Ms. TAYLOR. Okay. This is more about the method the Comptroller is using to sweep aside the State consumer protection laws. This preemption is not necessary. Congress gave the OCC a tool to use if a State law exerted too great a constraint on national banks. It is a process that involves public notice and public hearings. The Comptroller does not trust in this process, neither market-driven corrections nor the process set up by Congress. You, Congress, gave him a tool, with hearings. He has preempted the State laws of 50 States and the mission of 50 state attorneys general. If this is what you intended, we will live with it. If it is not, please do something.

Thank you very much.

[The prepared statement of Diana L. Taylor can be found on page 145 in the appendix.]

Chairwoman KELLY. Thank you very much.

Ms. Williams, I was interested that you said that the OCC acted because of compelling circumstances. I would like to know what those compelling circumstances were that forced you to finalize the rule 2 weeks prior to Congress reassembling, and if there was something that was important enough that forced you to do that 2 weeks prior to coming and testifying.

Ms. WILLIAMS. Chairwoman Kelly, I explained in some detail in my written statement, particular circumstances included the impact on the mortgage markets and credit availability of some of the State predatory lending laws. What we were seeing were situations where national banks were pulling out of markets. They were pulling out of markets because of the uncertain exposure that they would be subject to, the additional costs. They were pulling out because of the inability to sell loans from jurisdictions, both state and local, that had enacted predatory lending laws. These laws were coming into effect on certain timetables, so we were hearing that there were things happening in the marketplace. The timetables were kicking in. So we felt that it was appropriate to go ahead.

We felt that against a backdrop, though, as I said in my oral presentation, of an effort where we tried to be very open and inclusive of all interested parties in this process.

Chairwoman KELLY. Ms. Williams, I would like to know how many letters you received during the comment period. I would like to know how many Members of Congress actually wrote to the OCC during the rulemaking process, and what was the nature of the comments in both the letters from the Congress and from other people.

Ms. WILLIAMS. The precise numbers, Madam Chairwoman, I would have to get back to you on. I know of your letter. I know we got comment letters from some other Members. Your letter focused on the timing of the agency moving ahead. We had some letters that expressed concerns about the impact of the proposal on predatory lending. We had some letters that forwarded concerns that were constituent concerns about our proposal.

Chairwoman KELLY. I am aware of several dozen lawmakers who wrote in opposition to your finalizing the rules, including the Ranking Member and all of the Democrats on the Senate Banking Committee.

Ms. WILLIAMS. Yes.

Chairwoman KELLY. The Ranking Member and 16 other Democrats on Financial Services Committee, the vice chairman and two subcommittee chairmen of Financial Services Committee, as well as other senior Members of this committee, not to mention a bipartisan group of other Members in the House and Senate not on either committee of jurisdiction. If I am aware of all of those letters, I am interested still in what was the compelling reason why you needed to act before Congress could listen to what you had to say?

Ms. WILLIAMS. Again, Madam Chairwoman, there were events occurring that were having a real practical impact on the ability of banks to engage in certain activities.

Chairwoman KELLY. Could you give me a specific example of that?

Ms. WILLIAMS. There were particular State laws that began to kick in, one in New Mexico on the first of January. I believe that New Jersey went into effect on the first of December. There were other initiatives underway in other jurisdictions. There were consequences of the enactments of these particular State laws. The secondary market was being impacted. Institutions that made loans in some of these jurisdictions were finding that they could not securitize them. They could not gain additional funds in order to re-lend. There was a credit availability impact as these laws became effective.

Chairwoman KELLY. It seems to me there might have been an option to have Congress, or for you to declare a moratorium on State laws until the Congress could complete a thoughtful approach to these rules.

Mr. Miller, I know you would like to respond to that. I would like to ask both you and Ms. Taylor. I am particularly interested in getting answers to the questions, Mr. Miller, that you put in your opening statement. When I read it, I was interested that you had some very specific questions with regard to the implementation of the rules. Where will a State's anti-deficiency laws fall? And where will State laws mandating judicial foreclosure fall? I would like you to elaborate on your concerns and the implications of these rules.

Mr. MILLER. I would be very happy to, but let me just respond to your colloquy with Julie Williams, as well, briefly.

The market and the States could have taken care of the problems that she was just referring to. There is a good example cited in Diana Taylor's statement, when Georgia really pushed the envelope, probably further than anybody else, there were some real consequences in the market, including the secondary markets. It

looked like there would be unavailability of credit. The Georgia legislature then went back and changed the law. The same thing could have happened to New Mexico. The same thing could have happened to New Jersey. These rules were not necessary on January 7 to deal with those problems. Those States could have dealt with those problems.

As to the questions that you raised, the broad, broad nature of the preemption here, that I mentioned before, any condition that affects the ability to fully exercise the authority is preempted. All those things posed in the questions, basic consumer issues, basic consumer protections and consumer functions, could well be preempted by this far-reaching preemption by the OCC.

Chairwoman KELLY. Ms. Taylor, would you like to respond to that?

Ms. TAYLOR. Actually, I want to add one additional thing. I think that market forces will have a lot to say about this, too. This is a capitalistic country. One of the objections to the predatory lending laws, especially in Georgia and also in New York State is that the secondary market, the consequences in the secondary market of the secondary market buying a loan that was deemed to be a predatory loan. I just heard this morning that Fannie Mae had said that they will not buy mortgage loans made by national banks that do not comply with State laws, which I think is a very interesting thing to have happened. It shows that we have total confusion now. Where the OCC has tried to clear up something, more confusion is reigning now than did before.

Chairwoman KELLY. I just want to follow up on another piece of what you touched on, Mr. Miller. The OCC preemption rules really adopted for loans, but where do you think that leaves the consumer if a national bank engages in unfair or deceptive non-lending practices? Whose laws are going to govern there? Do we know?

Mr. MILLER. We do not know for sure, but it is very possible, very likely that the State laws have been preempted. It is pretty clear that the State authority to enforce those laws, if they have not been preempted, is taken away. So it all comes back to the OCC, which does not have the resources, cannot have the resources to do what 50 state attorneys general have done, what Diane and 49 of her colleagues are able to do, and does not have the expertise.

Look at what the final conclusion of all this is. If the OCC can decide massive preemption of State laws, eliminate state authorities in enforcing what is left, and set itself up as really the sole enforcement agency on consumer protection and related issues for national banks, and describe what those rules are, then really you are going to have a level playing field problem with state banks. They are going to say, those are much better rules; we want to play by those rules. There is going to be a force to have those be the rules, then, at the State level as well.

So what you would have is the OCC setting the basic consumer protection rules for state and national banks, and the agency having all this authority having the very least experience in these kinds of rules. That is why I think that this committee and this Congress really needs to look at the public policy questions here and balance the appropriate interests between banks and consumers and between States and Federal authorities.

Chairwoman KELLY. Thank you. I have gone over my time.

Mr. Gutierrez?

Mr. GUTIERREZ. Thank you very much.

I just want to go quickly back to Ms. Williams. When the Chair asked you about correspondence and letters from Congress, I was very surprised that you did not mention that on April 3 of 2003, nearly 9 months ago, you did receive a letter directed to the Director of Currency well before you promulgated these rules, in which we said we believe that such action would violate a clear congressional directive that States be permitted to augment Federal law; that said in that letter that we wrote, too, the OCC appears to be pursuing a conscious strategy of preemption that increasingly permits national banks, as well as national banks operating subsidiaries, whether a bank or not, to disregard most State laws, ignore virtually any request or directive of a State banking regulator; and that ended by saying we urge the OCC at a minimum to return to the presumption analysis standards of Barnett.

We wrote this letter and your office did exactly what we asked you, we gave you an opinion you should not do it. So it should be very clear that you did not do this in a void. It was not as though you did not hear from those of us that are at least elected, elected to do this kind of policy work. We gave you our opinion, and this was a bipartisan letter. Former Chairman Leach of the Banking Committee signed it, along with others, so I was pretty surprised.

When New York State legislators sent you a letter, they said, listen, can't you wait for us to get back together? Can't you wait for us to get back to Washington, DC so that we can be there, so that we can talk? It seems to me that you could have waited. The seventh, our schedule is pretty clear about when we are coming back to Congress and what the first date is, the State of the Union. I am sure Mr. Hawke follows when it is the President is going to be here and when he calls Congress to session. That was the first day we were back, for the State of the Union address.

Ms. WILLIAMS. Could I respond a little bit on the process point?

Mr. GUTIERREZ. Sure. Unlike the Chair of the committee, I am going to try to keep to the 5 minutes because then she will bang that gavel over my head. I am just kidding, but I will allow you to respond, please.

Ms. WILLIAMS. Maybe you will not count this against him?

Mr. GUTIERREZ. Sure.

Ms. WILLIAMS. We tried very hard to be very inclusive and to talk to everybody that had issues and concerns about what we were thinking about doing. As I said, I very much regret if we have created an impression that we were trying to get something out while Congress was out. In fact, the regulation appeared in the Federal Register I think about a week, just a week before you were back in.

Mr. GUTIERREZ. I understand. I just did not want the perception to be given at this hearing that, (A), Members of Congress did not fulfill their due diligence, and did not give an opinion 9 months prior to the OCC's opinion directives being issued. We did give you an opinion on where we stand.

Ms. WILLIAMS. We got a variety of opinions.

Mr. GUTIERREZ. I understand, but it seems as though since here before this committee, and there were Members of this committee that wrote that letter, you might have remembered that, but I understand.

And secondly, while we understand you did it on January 7, we did simply ask, at least the New York State legislators did ask to wait. I don't know what was so urgent about doing it on that day. I think in the future maybe if you wait for us to get back, we can all work together.

Let me just ask a question, because I think instead of asking you some of the technical questions, I want to ask you a general question on operating procedures under the new regulations. Mr. Rickoff, New York State, he took out a mortgage for $27,000; should have been paid off in 1999. He did not discover it until 2003 that he had paid another $10,000. But he kept paying his monthly bill each and every month. Mr. Hall called the bank. The bank, which is First Tennessee, explained that he had been undercharged $16 a month from his original lender, and that despite the fact that his loan had been sold twice, that has happened to me and I am sure everybody in this room, the oversight was not discovered until recently.

So the bank, the Third Bank I think in this case, it was finally sold to, said, you know what we are going to do because of that oversight of $16? We are not going to call the consumer and tell him, hey, you underpaid $16 or maybe go back to the other two banks and say, maybe there is some law here that says that you kind of screwed up on this. What we are going to do is we are going to unilaterally extend your mortgage from 30 to 41 years, just on our own. We are not going to tell you about it.

I think the story has been very well published. Here is what I would like you to respond to in terms of this issue, of a consumer. So the consumer goes to the Attorney General of the State of New York. I would like to put in the record the transcript. We have the original tape, Madam Chair, but this is a transcript.

Chairwoman KELLY. So moved.

[The following information can be found on page 232 in the appendix.]

Mr. GUTIERREZ. This is what the bank called back, an assistant Attorney General of the State of New York, says, Mr. Fleischer, who is the assistant Attorney General, this is Barbara Brown Eddy from First Horizon Home Loan Corporation returning your call, regarding the Richard Hall matter. You mentioned that you sent a letter to us. I am located in Texas. I do not know if that letter was sent to our Texas location or not, but it has not made it to the legal department. I need to advise you, assistant Attorney General in New York, right, that as an operating subsidiary of a national bank and pursuant to an advisory letter from the Office of the Comptroller of Currency, as an operating subsidiary of a national bank, we are governed by the OCC.

I am not going to read the whole letter for the purposes of time. She goes on to say she is not at liberty to discuss this any further with the assistant Attorney General. Basically, she is blowing him off, saying, I do not have to talk to you. The OCC says I do not have to deal with you, Attorney General, on this issue, and she

called him back. We have the tape. And then she says, but again, we would have to respond to any inquiry that is directed through the OCC, and not through a State agency. She leaves her number, which I am not going to repeat because then, who know, maybe she will receive thousands of phone calls and that would be unfair to her.

[Laughter.]

It really concerns me that if I, as a Congressman, I have someone come to my office, which I have all of the time and I hope they continue to come, what I usually do is I call my Attorney General, Lisa Madigan, because she has a consumer office. I cannot call the Mayor. He is a good guy, but is not really equipped. The county is really not equipped. The people that are really equipped are my state guys. They have a consumer fraud division. That is all they do, so I call them up. Are you saying that if I call her up and she tries to deal with the case, that I should really call you and your legal department, and not call my Attorney General? And that no one in the State of Illinois should ever bother again with the Attorney General when it comes to a nationally chartered bank?

Ms. WILLIAMS. No, sir.

Mr. GUTIERREZ. Well, you better tell this woman that, at the bank.

[Laughter.]

Ms. WILLIAMS. What we have said to national banks is if they are contacted by State officials concerning issues about enforcement of State law by the State officials, we want the national banks to tell us of those contacts. We have not told national banks you cannot talk to State officials.

Mr. GUTIERREZ. That is what she said. We will give you the tape.

Ms. WILLIAMS. I am not disputing what you got.

Mr. GUTIERREZ. But since you oversee them, I hope you reprimand them and tell them do not say that. That was the implication; that they did not have to deal with us.

Ms. WILLIAMS. Let me just say, what we have said. The second and larger issue here really is one of cooperation between the OCC and the States. It is something that we have been trying to work hard on and have not made as much progress as we wish we had.

We found out about this particular situation when we got a call from a reporter. When we learned about it, we called the bank. The bank got in touch with the people that handled the mortgage operation. It percolated up to senior management. People looked at it and said, there has been a mistake. There was a mistake made in 1974 when the monthly payments for this gentleman were calculated.

Mr. GUTIERREZ. You know something, we understand there was a mistake and we, most seriously, thank you that it was finally resolved and the gentleman got the situation corrected.

Ms. WILLIAMS. The situation is resolved.

Mr. GUTIERREZ. We understand that the situation is resolved. I understand that you guys took action when you learned about it. All I am saying is that clearly there are institutions out there, financial institutions out there like this one in this case that said to an Attorney General of a State and his office, elected official law enforcement officials. I mean, can you imagine a bank robber say-

ing that? That was an FDIC-insured bank. I crossed state lines. If the FBI does not call me, Chicago Police Department, I do not have to talk to you.

Start thinking about the ramifications. I do not know if the analogy is the best one, but it is what comes to mind. I am not trying to accuse the bank of being criminal in their intent, but they certainly hurt this consumer because in the end, the situation was rectified. I just want to say that we need to sit down. I know I am going to ask the Chairwoman and the Members of the committee to review this situation to see what we have to do legislatively, because the last time I checked, we could still pass laws here that do govern the OCC just in case there is some area of ambiguity here, so that we can clear that up.

Lastly, if you could send us in writing all of the times the OCC has sued and what damages the OCC has collected in civil court proceedings against financial institutions for fraud, predatory lending and other consumer violations. Please tell us how many staff people you have and how many are for each State of the 50 States, and whether you have developed a coordinated effort in each of the 50 States so that just in case we lose and you win, I know where to send my consumers.

Thank you.

Ms. WILLIAMS. Congressman, you always win ultimately because you make the laws. If I could make, just to clarify a point on process.

Mr. GUTIERREZ. But the bank has a lot of people here, too.

[Laughter.]

Ms. WILLIAMS. The issue about where the complaints come in is a very legitimate issue. What we have asked is that if a complaint concerning a national bank or a national bank operating subsidiary is received by a State agency, that they refer those to our consumer assistance group. We also get hundreds of referrals from States. We get referrals from New York. We get referrals from the New York AG's office. We get referrals from the New York AG's office concerning operating subsidiaries. We get referrals from Mr. Miller's office. We get literally thousands of complaints that come to our consumer complaint office that are misdirected. They do not concern national banks or the institutions that we supervise. We try to refer them to the agencies that have jurisdiction over the particular entities.

So I would second Superintendent Taylor's point that consumers do not always know the regulator of the institution that they are dealing with. What we try to do is to get the complaint to the regulator that is going to be in the position to act quickly and most effectively for the consumer. That is what we are about. We are not about trying to deprive the States of a role. We are not about trying to cut them out of a cooperative process. We are not against having a dialogue with them about what we are doing and whether what we have done has been adequate.

So it is not a question of eliminating the States from having a role in protecting their consumers. We have resources to do this. We are prepared to do it. We think it is our responsibility to do it. States have resource issues. Let them devote those resources to problems in other areas where there is not a regulator that is say-

ing, we will try to deal with this. Don't consumers benefit more if you spread the resources more widely?

Mr. GUTIERREZ. I beg leave of the committee. I have an 11:30 meeting and I am going to try to get back here, Madam Chair, as quickly as I can.

Thank you.

Chairwoman KELLY. Thank you very much, Mr. Gutierrez.

Mr. GUTIERREZ. Thank you to all the witnesses.

Mr. MILLER. Thank you.

Chairwoman KELLY. Ms. Williams, when you get your response written for Mr. Gutierrez, he has asked you about the civil complaints. I would like you also to include what jurisdiction you have over criminal complaints, please.

Ms. WILLIAMS. We do not have the ability to bring criminal charges. It would be the Department of Justice.

Chairwoman KELLY. So it would not be state attorneys general?

Ms. WILLIAMS. A state Attorney General can bring criminal charges against a national bank.

Mr. MILLER. Wasn't that preempted?

Ms. WILLIAMS. No. It does not say that.

Mr. MILLER. Doesn't it say non-banking criminal cases?

Ms. WILLIAMS. No. It says criminal laws. Generally applicable criminal laws are not preempted. In fact, we have worked very cooperatively, believe it or not, with Attorney General Spitzer on some matters. So generally applicable criminal laws are not preempted.

Chairwoman KELLY. It sounds to me, from Mr. Miller's question, there is a bit of confusion here that perhaps we need to discuss.

Ms. WILLIAMS. I would be happy to.

Chairwoman KELLY. I think there is confusion in general about this finalized rule. I am going to once again call on the OCC to not implement this rule until we have some clarity. It is not clear.

Mr. Garrett?

Mr. GARRETT. Thank you.

Just two general questions. The first question is to either Mr. Miller or Ms. Taylor. You will find no one on this panel, I believe, that is a stronger advocate for States's rights. I sit here thinking of the arguments that you are making and the regular phrase of States being the laboratory for experiments and new approaches, and what have you.

This committee also recently just was successful with FCRA and the benefit to the nation of having uniformity in that area. I was not around years back when that was passed or authorized the very first time, but I wonder whether some of the same arguments may have been made at that time, as far as the States rights issues, as far as local regulation on those issues, and that we are depriving the States of those areas that they have the expertise in. When we did it this time, I must say there was unanimity in saying that it is a system that is working and the worst thing in the world would be if we had not succeeded in reauthorizing the legislation.

So maybe we will find ourselves if this regulation stands, maybe we will find ourselves 20 years from now reauthorizing, and we will say we could never have done without this.

Mr. MILLER. Maybe, but I sure don't think so. I think there are some big, big differences. One difference is that you, this committee, this Congress, looking at a particular area and balancing the interests of consumers and lenders, and looking at the Federalism question, and it becoming clear to you that the preemption in this setting makes sense. That is the process we think should happen. This was done not by you as elected officials, but by a single bureaucrat. And it is done in a broad, breathtaking way, inconsistent with what has happened in the past.

What is being done here really goes to the core of the dual banking system. It will alter substantially the dual banking system that Diane Taylor described so well and has served us so well. So I think there are some real differences, both in terms of the process of the Congress weighing all these interests, and the scope of what is being done here, and the effect therefore on the dual banking system which has served us very well.

Ms. TAYLOR. Thank you. The preemption that is contained in the Fair Credit Reporting Act was done by a legislative body of elected officials responsible to the citizens of their States, and after considerable debate. This was done according to the process, and we fully, fully supported that. In fact, I think that CSPS testified in favor of that.

I just want to say from a regulatory standpoint, my philosophy as a regulator is that there are three things that we do. Number one, we are here to ensure the safety and soundness of the banking system. Number two, we are here to ensure that banks are allowed to make a profit and that there is a reasonable positive correlation between risk and return. The third leg of that stool is that we protect consumers. What is being done here is the regulatory bodies at the State level are being deprived of the third leg of that stool, which is to protect consumers. I think that is damaging to everybody.

Mr. MILLER. I think if you let this go, 5 years from now you will say, how could we have done that. The consequences will be so wide-range and so negative.

Mr. GARRETT. Thank you.

Ms. Williams, if I may, one of your opening remarks I made note of. It touched me. You said that part of the authority that allows the agency to go forward with the regulation was something to the extent of that Congress was silent, I may be paraphrasing you wrong, as far as enabling the States to act in this matter. Do you remember that language?

Ms. WILLIAMS. Yes. I think what I was trying to capsulize is the point that in the case of the preemption issue here, in essence, Congress has granted national banks a power under Federal law, and it has not conditioned those powers. You have States trying to say, no, you cannot do that, or you cannot do that except in these particular ways. Congress can say that State law is applicable to national bank activities and it has done that. There is, for example, intra-state branching. But it has not done that in the area of lending and deposit-taking, which are the areas specifically identified in our regulation. What you have is a Federal power that empowers the Federal entity to do a particular activity.

Mr. GARRETT. I guess I will just close on this. It seems that the arguments, where it turns the Federal idea upside down, and I am thinking of the Tenth Amendment that says all rights not specifically delegated to the Federal government are retained by the people and the States respectively. This, in essence, puts the onus on Congress, then, to know every single thing that the States are going to possibly do in the future, or might want to do in the future, and be specific in our legislation when we pass giving that authority, and say A through Z is what the States may do 5 years down the road and we have to think about that.

I would think the Constitution is the other way around, that the States can do anything they want to do unless we are specific and we have a constitutional authority, first and foremost, that allows us to pass that legislation to say they cannot.

Ms. WILLIAMS. Forgive me for sounding like a legal techie here, but the essential point is that Congress has acted here. It has given national banks certain powers. It has given those banks power without restriction. The basic Supremacy Clause argument is that if there is a Federal power or the Federal government has acted, then the States may not restrict the exercise of that power. That is a much, much distilled version, but that is the essence of the argument.

One thing I would add, there has been reference to what Congress did recently in connection with the Riegle-Neal legislation. I think it is very important to look, again forgive me for sounding like a legal techie here, but look at exactly what Congress said in Riegle-Neal. It identified certain types of State laws, including consumer protection laws, that would apply to branches of an interstate bank, but then the law says unless that State law is preempted by Federal law. And then Riegle-Neal further says that to the extent that any State law is applicable to the interstate branches of national banks, that State law shall be enforced by the Comptroller of the Currency.

So if you are looking for the most recent congressional enactment that reflects congressional intent, I would point you to that.

Chairwoman KELLY. Thank you very much, Mr. Garrett.

Ms. Maloney?

Mrs. MALONEY. Thank you, Madam Chairwoman. I think you and many others have raised many important concerns.

I would like to ask Ms. Williams, and following your argument, I would like to bring up the North Carolina State statute, which has been in effect for 3 years and many people say it is a very effective law in comparison to the Georgia law, which was too restrictive, and the rating agencies raised concerns and therefore it was struck and modified.

I think this gives an example of how Federalism or state actions help define and come up with solutions to the challenges before us. Do you know of any loan that was not given because of the North Carolina law? Or do you know any problem with the North Carolina law? This was cited several times in other hearings that we have had.

Ms. WILLIAMS. Congresswoman, I know of institutions that we regulate that have decided not to do subprime lending in North

Carolina and other States because of concern about triggering some of the——

Mrs. MALONEY. In North Carolina? Really?

Ms. WILLIAMS. Yes. There is a vigorous debate in the economic academic literature going on right now about whether the North Carolina law has had an effect on reducing legitimate subprime credit availability in North Carolina.

Mrs. MALONEY. I would request that in writing, because we have had several North Carolina bankers and consumer groups testify that it was a fine law and was working well. So if you have some examples where loans were not permitted in North Carolina because of the State law, I would really like to see that.

Ms. WILLIAMS. What I have is anecdotal, but I will be happy to provide you with copies of these economic analyses.

Mrs. MALONEY. No, I would like a factual example, not a think tank, but a consumer that did not get a loan because of that.

But I want to very importantly go back to the comparison or the Statement that Mr. Gutierrez used earlier. I found that very interesting. Most importantly, it seemed to me, the point of his example was that the consumer who was definitely wronged would never have known to call the OCC. In that particular case, and I would say in every case, a consumer would call people they know, the State Attorney General.

So my question to you, if this goes into effect, which I hope it does not, I think we need more debate and I think we need to have hearings. We had many, many hearings on credit. It absolutely dominated the agenda for this committee for 2 years. I would like to know, how are you going to reach out to consumers? Consumers do not even know who the OCC is. Are you going to have a massive public awareness campaign of ads on TV? If you have a problem with a loan, call the OCC, or if you cannot get information, call us?

I would like to hear from Superintendent Taylor and Attorney General Miller. I know that you have vigorous constituent services departments, because my office works with them on constituent challenges all the time. How many people in your divisions are now working in consumer protection agencies on a State level? Would their jobs then be preempted? Therefore, how many people do you have now in consumer-related assistance? How many more people would you have to hire if 50 state attorneys were then shifting their whole staff away from constituent service in this particular area to other areas? Do you understand what I am saying?

The bottom line that I hear in my office is what Mr. Gutierrez was talking about. If a consumer has a problem, they call us or they call the Attorney General. How are you going to help these consumers? No one knows who the OCC is except for those of us on the Financial Services Committee. How are you going to reach out and let the public know about this?

And can you respond, too, Ms. Taylor, on how many people in your office are working on this challenge now? What would happen to them?

Ms. TAYLOR. Actually, we have 18 people, I think it is, in our consumer protection bureau itself, but I would say that everybody in management at the banking department also works in consumer protection. I take several calls at least a day from legislators and

congresspeople and constituents with complaints. Everybody is involved in it to some extent.

Mr. MILLER. We have about 18 people as well in consumer protection, a broad-range of activity. But just think about the foolishness of it. If one of our investigators gets a call about a banking problem, the first thing they have to say, are you a State or a Federal bank, or a national bank? It is much more efficient for that person to just handle the complaint, particularly if it is a credit card complaint or something like that. There is no way that the OCC at the national level can handle these individual complaints.

One of the things we asked when we met with the Comptroller and Julie on this issue, what about the do-not-call list? Isn't what you are saying, doesn't that point to you having to do the do-not-call work for national banks? He said yes, we will do that. I mean, it just does not make sense in terms of efficiency and in terms of state and Federal relations; no sense at all.

Ms. TAYLOR. Congresswoman, could I just add something?

Mrs. MALONEY. Certainly.

Ms. TAYLOR. At the banking department, we get about at least 500 calls a day. That is one stat.

Ms. WILLIAMS. If I could wrap up on that particular point? As to numbers, we have between 100 and 200 compliance examiners. We have roughly 50 people that work in our consumer assistance group. All told, we have about 1,800 examiners. We have hundreds of examiners who are resident in our largest banks and who are on-site able to deal immediately with issues that are brought to their attention.

One of the important things to bear in mind here is that all we do is national banks and their subsidiaries. Mr. Miller has very broad responsibilities. Superintendent Taylor has responsibilities that go beyond just state-chartered banks. Our resources are directed at the safety and soundness and the business practices of national banks and the entities that they control. So we think we have sufficient resources to handle the issues. We are getting referrals from the States, as I mentioned earlier.

The issue here probably ought to be, how can we most efficiently work together with the States to get prompt resolution of customer problems. I have to tell you that when the national banks get a call from the OCC, they will respond very promptly. So what we ask the State AGs and the State banking departments is that if they get a complaint that concerns a national bank or a subsidiary of a national bank, to please refer it to us. We will try to resolve it. We are willing to collaborate with the State agencies to make sure that they know what we have done with it. We are willing to have a dialogue with them if they do not think we have done enough.

There is a legitimate issue with consumers of not being sure who is the regulator of the financial institution that they are doing business with. As I mentioned earlier, we literally get thousands of complaints that we refer to other regulators because those are the appropriate entities to handle the issue with that particular institution. So there is a lot of potential here to work together and to try to maximize prompt resolution of consumer issues. That is what we need to do.

Chairwoman KELLY. Thank you, Ms. Maloney. I am sorry.

Mrs. MALONEY. If I could place in the record an article in the New York Sun on the number of complaints that come into the OCC with Comptroller Hawke.

Chairwoman KELLY. So moved, without objection.

Actually, without objection, we have several statements that Members have asked to include in the record. They are letters of correspondence from Members to the OCC. There is a comment letter signed by all 50 state attorneys general, and statements from the National Association of Realtors, the Mortgage Bankers Association of America, and the Financial Services Roundtable. Without objection, they will be added to the record. So moved. Thank you.

Mr. Davis?

[The following information can be found on page 274, 367, 386, and 354 in the appendix.]

Mr. DAVIS. Thank you, Madam Chairwoman.

Let me say, Ms. Williams, if I can get a better understanding of exactly what is the scope of these regulations that we have been talking about today. Let's say that against all odds, that tomorrow the Alabama legislature passes some kind of venturesome new law that deals with discriminatory practices in the lending market. Is that law going to be preempted under the OCC regulations?

Ms. WILLIAMS. When you say "discriminatory," discriminating against an individual in getting a loan?

Mr. DAVIS. Yes.

Ms. WILLIAMS. No. It is not preempted.

Mr. DAVIS. All right. Now, let us say that the day after that the State of Alabama passed some kind of an unfair lending practices act and they did not refer to it as an anti-discrimination act, but they described it in terms of unfair lending practices. Would that be preempted?

Ms. WILLIAMS. If what they were passing is a law that says essentially do not engage in unfair and deceptive practices, that would not be preempted.

Mr. DAVIS. Let me try to put that in the context, though, of something that you said at the outset. One of the things that you said in your opening statement is that the OCC lacks the power to really define what constitutes a deceptive practice. One of the concerns you have heard from several Members on the committee is whether or not we have a strong enough national framework in place right now and whether the OCC has adequate power right now to address predatory lending and to address problems of deceptive practices.

If the OCC does not have the power to define what constitutes a deceptive practice, doesn't it seems fairly obvious that there is some congressional intent for the States by definition to pick up some of that slack and have a fair amount of leeway in that area?

Ms. WILLIAMS. Congressman, this relates to how the rulemaking authority under the Federal Trade Commission Act is allocated. What Congress did, and you can certainly change this, is to provide that with respect to banks, that the rulemaking authority is vested solely in the Federal Reserve Board to define particular acts or practices as unfair or deceptive.

Mr. DAVIS. Let me ask this follow-up, then. Mr. Miller, do you agree with Ms. Williams's observations that if Alabama or your

State of Iowa were to pass an anti-discrimination law tomorrow with respect to lending practices that it would not be preempted?

Mr. MILLER. I think that is correct.

Mr. DAVIS. Do you agree with her characterization that if there were to be some kind of an unfair lending practices act it would also not be preempted?

Mr. MILLER. I think there is a great likelihood that that would be preempted.

Mr. DAVIS. That is would be preempted?

Mr. MILLER. It would be preempted because it would impose conditions on their ability to make loans.

Mr. DAVIS. Okay.

Mr. MILLER. That just fits this broad, broad prohibition; this broad, broad preemption that I just talked about. It is hard to imagine anything in the consumer protection area that would not be preempted by this. That is why this is so revolutionary.

Mr. DAVIS. So Ms. Williams, your argument would be, if I understand it, that there is something unique about discrimination laws? I recognize we are not talking about that in a normal Title VII context, but you are saying there is something unique about the use of the phrase "discrimination" that somehow takes it out of the preemption zone. Is that your position?

Ms. WILLIAMS. Let me explain it in a different way and clarify the point that Attorney General Miller was raising in response to your question and my earlier answer. If you have a State law that says do not engage in unfair and deceptive practices; do not discriminate in your lending practices; of course, we do not argue that it would interfere with a national bank's Federal powers that it has to be allowed to engage in unfair or deceptive practices or discriminatory practices. That type of law protects against practices that are fundamentally inconsistent, abhorrent, to national banks and the way we want to see the national banking system operate.

If you have a State law, and it may be labeled a fair lending law, that says you can only make loans with these terms, not that you cannot make loans that are unfair or deceptive, but you can only make loans with these terms, that kind of law comes in conflict with the authority under Federal law that national banks have to make loans. That lending authority is not subject to that kind of state-imposed condition.

Mr. DAVIS. Let me make this one observation, Ms. Williams, and I suspect the Attorney General might agree with this. I understand as a practical matter how the nomenclature works, but in terms of how policy is made in this area obviously the State's ability to attack all of the problems that make up the whole culture of predatory lending now, it might be, if I have time to finish this observation, it might very well be that that attack is pursued just as aggressively under one type of claim, some kind of a fair lending claim, that does not purport on its face to address discrimination.

It may be the that one could raise some kind of anti-discrimination claim, but I think the Attorney General's concern is that given the relative lack of enforcement power the OCC has, if we truly view this as a national problem, if we think it is affecting the fairness of the market, don't we want to provide at least enough opportunity for the States and for regulators to use whatever tools are

available and not have to just crowd them under one particular label?

Ms. WILLIAMS. What I would take issue with you on is your Statement about our relative lack of enforcement authority. We have a tremendous arsenal of enforcement tools, informal supervisory actions and a number of types of remedies and enforcement actions we can take. We can take action against unfair and deceptive practices. I would point you to probably the most notable situation which involved a bank out in California that was engaged in some inappropriate credit card marketing practices. We took an enforcement action against that institution. We took that action under Federal law and we also enforced the California Unfair and Deceptive Practices Act, and we got over $300 million in restitution for the customers of that institution.

So we have a tremendous arsenal of tools that we can use to deal with these issues. We have the ability to use them in all different levels and to get very quick response from the institutions we supervise.

Chairwoman KELLY. Thank you very much, Mr. Davis.

Mr. Crowley, have you questions for this panel?

Mr. CROWLEY. Thank you, Madam Chair.

Just for Ms. Williams, there is no question if one examines the recent history in New York State and the success rate of our Attorney General, Mr. Spitzer, especially as it pertains to use of the Martin Act in New York state in going after ill-practices on Wall Street. We may also have a situation here, and I will use for example the one case that I know of with First Tennessee in which on behalf of an upstate New Yorker who had a loan dating back to the 1970s ended up paying his loan and then some, only to find out that he had overpaid by almost $10,000 to First Tennessee, that was not the original bank. He could not get any justice, basically. He needed to find a way to do that and went to the Attorney General's office. In the interim, I understand that OCC got involved.

What can be done to help, because he had the opportunity of a perfect storm again. You have this one individual that Mr. Spitzer can come in and really do the right thing by and bring the proper pressure to bear. What mechanism exists right now between OCC and attorneys general like Mr. Miller, like Mr. Spitzer? And what can be done to better those relationships? What penalty, for instance in First Tennessee, was brought to bear upon them for this outrageous act? And what will be done in the future to help stymie that, outside even from criminal? I am talking about this from the monetary point of view.

Ms. WILLIAMS. Congressman, you missed a little bit of my discussion of the processes of referrals between the OCC and the States. We have processes where when we get consumer complaints that pertain to institutions that we do not supervise, we refer those to the appropriate state agencies or other Federal agencies. We also get referrals from the States, the State banking departments, from state AGs. We get referrals from Mr. Miller's office. We get referrals from Mr. Spitzer's office. We get referrals from Superintendent Taylor's office.

What happened here is that once the AG's office became aware of this particular issue, rather then calling us or referring the matter to us, the AG filed a lawsuit.

Mr. CROWLEY. That is one way of getting your attention, I guess.

Ms. WILLIAMS. It did. I heard about it from a reporter. We followed up immediately with the institution. They got the issue up to a level of management that looked at the situation and said, this is not the customer's mistake. This was a mistake that occurred in 1974 when somebody miscalculated what the monthly payment should have been. Their immediate reaction was, we want to fix this for the customer, and they have. It has been resolved. It was not necessary to file a lawsuit. We could have resolved this much more quickly.

Mr. CROWLEY. What was the resolution?

Ms. WILLIAMS. As of the date that the customer originally thought that he had paid off the loan, everything that he paid beyond that has been re-funded, and a certain amount of attorney's fees are being paid to his attorney for her time in handling the matter.

Mr. CROWLEY. I appreciate that, Ms. Williams, but I think also, from reading the press clips that I have read, that apparently the communication between OCC apparently, and Mr. Spitzer's office, were maybe not as good as they ought to have been.

Ms. WILLIAMS. It was nonexistent in this case, and that is unfortunate.

Mr. CROWLEY. Even after you resolved the problem, is what I am saying.

Ms. WILLIAMS. That I cannot speak to.

Mr. CROWLEY. There is this one article I will bring to your attention.

Ms. WILLIAMS. Okay, thank you.

Mr. CROWLEY. Because in my opening statement, I have already said I am somewhat sympathetic toward what you are trying to do, and at the same time cases like this make my job much more difficult. So I would appreciate in the future, as was mentioned before, the Chair also had some difficulty in terms of the communication between her office and OCC. Those kind of things do not help us in our daily lives.

Ms. WILLIAMS. I understand.

Mr. CROWLEY. I appreciate it. I yield back.

Chairwoman KELLY. Thank you, Mr. Crowley.

The Chair notes that there are Members who may have additional questions for this panel which they will submit in writing. Without objection, this hearing record will remain open for 30 days for Members to submit written questions and for witnesses to place their answers in the record.

We thank you for your time and your patience this morning. With that, this first panel is dismissed.

Mr. MILLER. Thank you, Madam Chairman.

Chairwoman KELLY. We thank you, Mr. Miller.

While the second panel is taking their seats, the Chair will introduce them. The first person is Mr. Edward L. Yingling, an Executive Vice President at the American Bankers Association; Mr. John Taylor, President and CEO of the National Community Reinvest-

ment Coalition; Ms. Karen M. Thomas, the Director of Regulatory Affairs at Independent Community Bankers of America; Mr. Joe Belew, President of the Consumer Bankers Association; Mr. W. Lee Hammond, a member of the board of directors at AARP; and Mr. Hilary O. Shelton, Director of the Washington Bureau for the National Association for the Advancement of Colored People.

While this panel is being seated, let me just remind the panelists that there is a box at both ends of the table indicating the lights. The red light means stop; the yellow light means you have 1 minute left; and the green light means it is time for you to begin.

I appreciate your testimony and your appearance here before the subcommittee. If the panel is ready, let us begin with you, Mr. Yingling.

STATEMENT OF EDWARD L. YINGLING, EXECUTIVE VICE PRESIDENT, AMERICAN BANKERS' ASSOCIATION

Mr. YINGLING. Thank you, Madam Chairwoman. We appreciate your holding hearings on the recent OCC rule.

The ABA strongly supports this rule. We believe it is firmly based in law. I have been involved in banking law for 30 years. In the last 20 years on my office wall I have had replicas of the signature pages from two banking acts dated February 25, 1863 and June 3, 1864. The signatures are Abraham Lincoln's. While Lincoln is obviously better known for other great accomplishments, these two acts together represent his great contribution to financial regulation. That contribution is the creation of the national banking system, and therefore the dual banking system.

In creating the national banking system, Congress explicitly gave to the OCC exclusive powers to regulate national banks. Congress also gave the Comptroller the authority to preempt state and local laws that would conflict with those powers. This is a key point. One hundred and forty years ago, Congress clearly gave the OCC the authority that is used in this rule. Previous Comptrollers have used that power in many instances over the last 140 years. Furthermore, court after court, including the Supreme Court many, many times, has upheld that authority, as shown in the list of cases attached to my testimony.

Despite the controversy, to a very large degree the OCC rule does not break new ground. The areas covered in the rule have in many cases already been subject to preemption by the OCC. In the past, these preemptive rulings went forward generally on a case-by-case basis. That approach worked when state and local actions that were preempted occurred infrequently. Recently, however, we have seen a proliferation of such state and local actions. These actions often ended up in the courts, where preemption was always upheld.

We believe, therefore, that it was very important that the OCC issue this rule in order to make it clear to all parties where the line on preemption is. While most legal experts in this arena know that state and local laws that impinge on the fundamental activities of national banks are preempted, state and local officials have often proceeded despite the virtual certainty that their efforts will be struck down by the courts.

In the meantime, national banks face costly uncertainty as to how to proceed with the affected businesses. Banks, the OCC and

the taxpayers of those state and local governments end up wasting resources in litigation. This OCC rule will help avoid that uncertainty and litigation costs by bringing together in one place what was in fact occurring on a case-by-case basis in any event.

A second key point, what many of the opponents of the rule are advocating would in fact render the dual banking system virtually meaningless. The areas addressed by the OCC rule, lending and deposit-taking, are fundamental to the business of banking. If state and local laws can regulate these most basic of national bank activities, and if States can examine national banks, what is left of the national banking system? Simply put, for a national banking system to exist, state and local governments must not be able to impose material restrictions on the fundamental banking activities of national banks.

Finally, much of the debate over the rule has been in the context of the need to address the terrible problem of predatory lending. There are two approaches to predatory lending that we believe would work well, without undermining the dual banking system. The first involves cooperation between the OCC and state and local officials. State and local governments should work with the OCC to identify any problems and recommend changes in the regulation of national banks that may be necessary to address those problems. The OCC has indicated strong interest in this type of cooperation.

In addition, should state and local authorities find specific situations in which national banks may be engaging in unethical or illegal activities, they should forward this information directly to the OCC for action. We are confident that the OCC would take strong action and has the authority to do so. Under this approach, state and local governments would not try to regulate the fundamental activities of national banks, and therefore the dual banking system would be maintained.

A second approach, not inconsistent with the first, is the passage of targeted Federal legislation to address predatory lending. There are a number of areas where Congress has determined that a Federal approach to a given consumer protection issue is warranted. As noted earlier, this approach was recently taken by this committee with respect to the Fair Credit Reporting Act. We recommend that the Congress actively consider proposals for a national approach to predatory lending, such as that contained in the Responsible Lending Act introduced by Congressman Ney and others.

Thank you for allowing us to testify this morning.

[The prepared statement of Edward L. Yingling can be found on page 214 in the appendix.]

Chairwoman KELLY. I thank you, Mr. Yingling, for staying within the time frame.

Mr. Taylor?

STATEMENT OF JOHN TAYLOR, PRESIDENT AND CEO, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. TAYLOR. Good afternoon, Madam Chairwoman and Representative Crowley and other Members of the committee. Thank you for the opportunity to testify. My name is John Taylor. I represent the National Community Reinvestment Coalition, which is

a coalition of some 600 community organizations, local governments, and state-based institutions whose essential common interest in NCRC is to work together to promote fair and equal access to credit and prevent lending discrimination.

I want to begin actually by answering a question that you asked, Madam Chairwoman, as well as some of the others, I think Representative Gutierrez and Representative Maloney, on how the process went for the OCC in getting public comment and how they listened to that comment both from Congress and from other people. The question was asked, how many comments did they receive and how did that break out. I am sorry that Ms. Williams did not have those figures, but I happen to have those for you. There were 2,100 comments received by the OCC on this rule. Only 5 percent supported the position they took. I think that is fairly significant in light of the questioning that you had earlier.

Let me also say I am glad to hear that my friend and colleague from the American Bankers Association had some quotes from Abe Lincoln on his wall, but I would be pretty shocked if President Lincoln were here that he would not indeed agree with the States rights positions to be able to prevent unfair lending practices on the State level, and also endorse a national bill that made sure that lending discrimination, or rather predatory lending, became a thing of the past.

Unfortunately, it has surged in recent years, and now more than ever we do need these state anti-predatory lending laws, indeed, one on a Federal level. We need more consumer protections, not less, since the OCC has just boldly preempted state anti-predatory lending laws in nearly 25 States. NCRC, the National Community Reinvestment Coalition, recently issued a report called The Broken Credit System. I believe we gave all Members of the Banking Committee a copy of this report, and it was widely covered in the Wall Street Journal and New York Times, and many of the other major press. If anybody needs a copy, we will make sure you get it.

The important thing to understand is that we have found that predominately African American and elderly communities, and I want to recognize my friends from the NAACP and AARP who endorsed and supported our study, that showed that African American and elderly consumers were in fact targets of the subprime market, even when controlling for credit scores, housing stock and income.

We actually did this study in 10 of the large metropolitan areas including Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis and Washington, DC. After controlling for credit risk and housing market conditions, we found an increased amount of high cost subprime lending in elderly and minority neighborhoods. I can give you some examples about that, but I am going to move ahead to make sure I cover more substantive points in my testimony.

While price discrimination is insidious of itself, it is often combined with abusive terms and conditions that compound the evils of predatory lending. Overpriced loans with abusive terms and conditions strip the equity out of borrowers's homes and often lead to foreclosure. NCRC operates a Consumer Rescue Fund initiative that has responded to numerous examples of predatory lending.

Under the initiative, NCRC arranges affordable refinance loans for victims of predatory lending. I have heard some examples from Members of Congress. There probably is not a Member of Congress who has not heard from more than one constituent about these kinds of practices. So I am not going to bother to give you the examples because I think you know them well.

It does destroy affordable housing initiatives and community development initiatives, particularly in working poor communities and predominantly minority communities, when predatory lending and usurious subprime lending is able to be the law of the land in those neighborhoods. Lest you think that we are exaggerating about the impact of predatory lending in those neighborhoods, let me give you one example of a case that our rescue fund handled. It represented one neighborhood in New York City. There were 400 families impacted and victimized by predatory developers, appraisers, brokers and lenders.

When the OCC preempted state anti-predatory laws a couple of weeks ago, 25 States suddenly lost their ability to protect their citizens from equity stripping, massive foreclosures and loss of wealth. By the way, the OCC is attempting to expand this preemption, and this committee should know it, via the new proposed CRA regulatory changes that were just announced where they are attempting to have this sort of standard also incorporated at the other agencies. I think this committee ought to be aware of that. They are looking for partners, is what I am suggesting.

The OCC preempts comprehensive state anti-predatory lending law. Make no mistake about it. The OCC's regulation States that a national bank shall not make a loan predominantly on the foreclosure value of a borrower's collateral without regard to the borrower's repayment ability. The rule further prohibits national banks from engaging in practices that are unfair and deceptive under the Fair Trade Commission Act. So essentially, they say don't break the law, the Fair Trade Act, and do not predominantly make your decision based on foreclosure. So you can sort of still loan against the foreclosure value, but it should not be the predominant factor. By the way, in terms of when the OCC assesses them and regulates them, there has to be a pattern and practice of this. So you can do this some of the time and it can be part of your decision, so the OCC's regulation is not quite hard and fast.

Let me say, that red button unless you inadvertently clicked on it, means my time is up. So I will close by suggesting that the key thing to understand here is that the OCC regulation does not explicitly prohibit many things that in fact are predatory practices, including loan flipping, lack of income verification, single premium credit insurance, steep prepayment penalties, fee packing, high balloon payments, and other forms of practices that are in fact quite clearly predatory lending practices. None of that is covered except by State law, and it gets preempted by this rule.

I would suggest to you, too, that the notion that the OCC banks do not participate in this kind of activity, when they do about 4.2 million mortgage loans per year, that is, the institutions they regulate are about 28 or 29 percent of the entire loans in this country is absurd. We need to look at what those banks are doing in pur-

chasing those loans and what their activities are, and do not assume that they are not a part of the practice.

I will conclude by saying that I agree with my colleague from the ABA and some of the Members on both sides of the aisle who have said that it is high time for a national standard, but only one that is as good as the strongest state standard, so that the way we deal with this problem and create parity and fairness across the land is to create a strong comprehensive anti-predatory lending legislation that drives all these usurious, unscrupulous kind of lenders out of the business.

Thank you very much.

[The prepared statement of John Taylor can be found on page 167 in the appendix.]

Chairwoman KELLY. Thank you, Mr. Taylor. You have accomplished something very few people in front of my committees do. You have managed three endings, and that is okay. You did run over your time. I want to ask you one question here. That report is something of interest. I read pieces in your testimony from the report. Would you like to make that report a part of the record for this hearing? Or would you rather it just be available to our staffs? I think that is something that our staffs probably should have, if they do not have already.

Mr. TAYLOR. I would like to make that as part of the congressional record, Madam Chairwoman, as well as our Statement to the OCC, along with Members of Congress and 2,100 others who wrote to them about this proposed rule.

Chairwoman KELLY. Then the NCRC report and its statement to the OCC will become a part of the record. So moved. Thank you for your testimony.

[The following information can be found on page 290 and 347 in the appendix.]

Mr. TAYLOR. Thank you.

Chairwoman KELLY. Ms. Thomas?

STATEMENT OF KAREN THOMAS, DIRECTOR OF REGULATORY AFFAIRS, INDEPENDENT COMMUNITY BANKERS OF AMERICA

Ms. THOMAS. Good afternoon, Madam Chairwoman, Ranking Member Gutierrez and Members of the committee. I am Karen Thomas, Director of Regulatory Affairs and senior regulatory counsel for the Independent Community Bankers of America. I am pleased to share with you ICBA's views on the OCC preemption rule.

When first proposed, OCC's preemption and visitorial powers rules engendered heated controversy and debate, pro and con. With issuance of the final preemption rule earlier this month, the controversy over the rules remains. Strong views and feelings have been expressed on both sides as to the legitimacy and appropriateness of the rule.

In general, as expressed in our comment letter on the rule, the ICBA believes it would have been preferable for the OCC to continue to analyze how individual State laws impact national banks and make preemption determinations on a case-by-case basis, rather than adopt a broad, general preemption regulation. In our judgment, the importance of the Federal-state relationship mandates

than whenever preemption is undertaken, it should be carefully considered in the context of an individual statute. Each case should be evaluated on its own particular merits.

Overall, we are concerned that the scope of the OCC rule may not maintain the creative balance that characterizes our unique dual banking system. The issue is, does the OCC rule go too far? It may have, but for us it is not a clear-cut case. Our position is taken in the context of the increasing concern that community bankers have expressed about the growing trend among state legislatures to pass aggressive consumer protection measures that, although well intended, increase banks's regulatory burden and have negative unintended consequences for bank customers.

Consequently, ICBA has strongly supported on a number of occasions Federal preemption of State laws. For example, we have supported preemption of State laws such as the Georgia anti-predatory lending statute, laws banning ATM fees, and insurance sales laws that restrict how banks can sell insurance.

The OCC notes it adopted the rules to assist national banks and their customers because overlaying state and local requirements on top of the Federal standards that already apply imposes excessively costly and unnecessary regulatory burden. This statement resonates well with community bankers facing an ever-growing mountain of regulation.

To illustrate, secondary market investors stopped buying loans originated in Georgia because they were not willing to take the risk that they might purchase a loan considered predatory. Liquidity dried up as secondary market lending slowed significantly. Once the OCC preempted the law for national banks, a hard-fought for parity clause in the Georgia law meant that state-chartered banks were also exempt. Without preemption, Georgia consumers could have been seriously disadvantaged in their ability to secure mortgage loans.

Consumers deserve accurate information about financial products and services and protection from unscrupulous providers and unfair or misleading practices. To analyze whether consumers are adequately protected under the OCC rule, several considerations must be kept in mind. First, the rule expressly affirms that national banks must treat all customers fairly and shall not engage in unfair or deceptive practices as defined under the Federal Trade Commission Act. The OCC has previously taken actions against national banks for unfair and deceptive practices, and affirms it will continue to do so.

Second, the new rule's anti-predatory lending standard is intended to prevent national banks from making a consumer loan where repayment is unlikely and would result in the lender seizing the collateral. Finally, national banks are subject to a broad panoply of consumer protection statutes enacted by Congress, including Truth in Lending, RESPA, ECOA, HMDA, Truth in Savings and many others. Federal bank regulators ensure compliance with these requirements through regular rigorous examination and supervision.

The dual banking system has served our nation well for more than 100 years. While the lines of distinction between state and Federally chartered banks have blurred greatly, community bank-

ers continue to value the productive tension between state and Federal regulators. However, many community bankers view one set of rules issued by one Federal bank regulator as an undue concentration of power. We do not know whether the OCC's preemption rule will disturb the balance of the dual banking system by giving national banks too much advantage over state-chartered banks. But OCC preemption of State laws is only one side of the coin. The other is state action that impinges on the powers of national banks or undermines appropriate Federal supervision and regulation. For example, as Chairman Greenspan has warned, state-chartered industrial loan companies have the potential to undermine holding company supervision and regulation, while breaching further the separation of banking and commerce.

The principle of Federal preemption is a long and well-established one, but where the lines should be drawn continues to be debated. Preemption is a complex subject requiring a balancing of interests. While many community banks support some preemption, many are also uncomfortable with a policy of blanket preemption. A broad preemption regulation will not eliminate challenges to the OCC's authority, as we have already seen. The ICBA is concerned that a broad preemption may have unintended and unforeseen consequences. We would prefer an analysis of the unique elements of a particular State law before a decision to preempt is made.

Thank you. I would be pleased to answer any questions.

[The prepared statement of Karen M. Thomas can be found on page 181 in the appendix.]

Chairwoman KELLY. Thank you, Ms. Thomas.

Mr. Belew?

STATEMENT OF JOE BELEW, PRESIDENT, CONSUMER BANKERS' ASSOCIATION

Mr. BELEW. Thank you, Madam Chairwoman. Thank you very much for convening these hearings. My name is Joe Belew. I am President of the Consumer Bankers Association. I will also keep my remarks brief.

As indicated in my written testimony, CBA strongly supports the OCC in its recent rulemaking efforts to clarify the extent of its authority over national banks and their subsidiaries. Its actions are in accord with the letter and the spirit of the National Bank Act, as that law has been consistently interpreted by over a century of court opinions.

The rules were issued against a backdrop of stringent OCC examinations on a very broad sweep of Federal consumer protection laws, as well as safety and soundness laws. We would call the committee's attention to the list we provided of these Federal statutes. They cover virtually every imaginable area of consumer protection. Further, the OCC has been forceful in its enforcement of these laws. National banks do strive to be the gold standard in their dealings with the public. The OCC is swift and sure in those rare instances where it discovers wrongdoing.

The OCC's tough approach is not new. As far back as June of 2000, Counsel Julie Williams put the industry on notice at a CBA conference that the agency would use all its powers to anticipate and address any predatory lending concerns.

As we note in our testimony, our members, which are predominantly national banks, are also going beyond the requirements of the law and promoting financial literacy programs. This is important since we have injected predatory lending into this debate. For 3 years, we have surveyed our member banks to determine how involved they are in financial literacy efforts, as a measure of their sense of responsibility to the communities they serve. The most recent survey showed that 98 percent of the respondents sponsor financial literacy programs or partner with others.

Tough enforcement by the OCC, coupled with our industry's financial literacy efforts and a widespread understanding, which has been noted several times this morning, that problems are seldom being caused by national banks, they are not the majority cause, lead us to support the OCC rules as sound public policy.

To be sure, there is another reason, and that is banks' needs for predictability and uniformity across multiple States of operation. CBA's members, generally the country's larger financial institutions, typically operate in multiple States. Some are in over half the States of the Union, and many operate literally thousands of branches and have millions of customers. Increasingly in recent years, national banks have been facing the intrusion of state and local statutes and regulations. There was a need for clarity, greater uniformity, and predictability. These regulations will prove helpful.

Thank you very much for the opportunity to appear today.

[The prepared statement of Joe Belew can be found on page 58 in the appendix.]

Chairwoman KELLY. Thank you, Mr. Belew.

Mr. Hammond?

STATEMENT OF LEE HAMMOND, BOARD MEMBER, AARP

Mr. HAMMOND. Good afternoon, Madam Chairwoman and Ranking Member Gutierrez and Members of the subcommittee. My name is Lee Hammond. I am a member of AARP's board of directors.

I appreciate the opportunity to offer AARP's assessment of the Office of the Comptroller of Currency's recent action to preempt the application of State laws to national banks and their operating subsidiaries. Chairman Kelly, I also appreciate your including our written testimony in the record of the hearing.

While the recent rulemaking by OCC broadly preempts State laws affecting virtually all aspects of national bank and operating subsidiary activities, my testimony is focused on the OCC rule's impact on State laws and enforcement actions designed to stop predatory mortgage lending. The number of victims of predatory mortgage lending, many of whom have come to AARP for assistance, continues to grow.

In 1998 and 2000, HUD, the Federal Reserve Board and the Treasury Department issued reports defining predatory lending, chronicling its established patterns and its growth. We are very concerned that the OCC has both exceeded its authority under the National Bank Act and has minimized the breadth of the problem of predatory lending rule in its new rule.

We believe the OCC is attempting to substitute a single substantive regulatory provision for the broad range of consumer pro-

tections that currently exist under state anti-predatory mortgage lending and unfair deceptive acts and practices law, the latter referred to as the UDAP laws. Victims of misrepresentation, deception, fraud and unconscionable practices may be denied redress against the perpetrators of these offenses, if the perpetrators are national banks or their operating subsidiaries.

AARP is particularly concerned about the OCC's decision to extend the preemption of State laws to operating subsidiaries of national banks. Our view is that national banking laws do not afford unrestricted preemption of state authority over activities of national banks or their operating subsidiaries. In part, we base our views on state predatory lending laws that are authorized by the Federally enacted Homeownership and Equity Protection Act, referred to as HOEPA. HOEPA establishes a category of high-cost real estate loans and restricts the activities of mortgage lenders in connection with those loans.

Confronted with the growing complaints about abusive lending practices against their citizens, and with homeowners losing their homes to foreclosure, state legislatures and regulatory bodies seized upon the authority granted them by Congress under HOEPA to expand their consumer protections. Our view is that Congress, by enacting HOEPA, has made it clear that HOEPA and State laws modeled on HOEPA legitimately restrict the activities of any high-cost lender. We believe this includes national banks and their operating subsidiaries.

AARP supports stronger Federal legislation to stem the tide of predatory mortgage lending. We also support State laws and regulations designed to avoid preemption problems by avoiding rate and fee setting, and by using HOEPA as a legislative model. AARP submits that OCC's broad preemption is not merely unauthorized, but that it undermines the Federalism principles to the deterrent of the public interest.

Beyond this, we believe that OCC's preemption action deprives the judiciary of the visitorial powers to regulate and supervise granted to it by Congress. We believe that under the new OCC rules, state authority to sue national banks to enforce state banking laws, including consumer protection laws, would effectively be eliminated. It leaves regulation of a large segment of the mortgage market to the limited enforcement resources of the OCC. In addition, the OCC's rules weaken state authority to enforce those few laws that the OCC does not preempt, thus enabling national banks to avoid those laws as well.

The breadth of the OCC's preemption remains to be tested in litigation, but the harshest impact will likely be felt by those with the greatest need for State law protection, homeowners facing foreclosure. The OCC has likely deprived homeowners of the ability to raise State law defenses to foreclosure when the mortgage is originated on a national bank or one of its operating subsidiaries.

AARP believes the activity of these entities must be subject to examination regulation by the States and to state-created private rights of action to provide redress to their consumers. We appreciate the purpose served by this hearing in raising congressional and public attention regarding the risks to consumer protections posed by the OCC rules.

I will conclude by making two summary points. First, we believe that the OCC is undermining state efforts to protect consumers, and thereby taking action that is harmful to the public interest. Second, we believe that prompt and decisive congressional action is necessary to curb the OCC's exercise of powers that far exceed those delegated to it.

I would be happy to answer any questions you may have.

[The prepared statement of W. Lee Hammond can be found on page 73 in the appendix.]

Chairwoman KELLY. Thank you, Mr. Hammond.

Mr. Shelton?

STATEMENT OF HILARY SHELTON, DIRECTOR, WASHINGTON BUREAU OF THE NATIONAL ASSOCIATION FOR THE ADVANCEMENT OF COLORED PEOPLE

Mr. SHELTON. Thank you, Chairwoman Kelly, Congressman Frank, Congressman Gutierrez and all the Members of the full committee and subcommittee, for inviting me here today. I appreciate the opportunity to provide you with the views of the NAACP on this very important matter.

My name is Hilary Shelton and I am the Director of the Washington bureau of the NAACP. The Washington bureau is the Federal public policy arm of our nation's oldest, largest and most widely recognized grassroots civil rights organization. With more than 2,200 membership units in every state in our nation, the NAACP knows that predatory lending, which is rampant in our communities, hurts individuals, destroys neighborhoods and poses a real risk to our nation's future.

Let me begin by saying that the NAACP is strongly opposed to the new regulations issued by the Office of the Comptroller of the Currency, as they will clearly eviscerate the limited protections that we currently have in place in a few States to address the scourge of predatory lending. Furthermore, as put forth by the OCC, the new regulation will in fact exacerbate a broken financial system which results in prolonged poverty and the targeting of individuals and neighborhoods because of their racial and ethnic makeup.

Predatory lending is clearly a major civil rights issue. As several studies have shown, predatory lenders prey on African Americans and other racial and ethnic minorities in vastly disproportionate numbers. Two important reports from 2002 show that "African Americans were 4.4 times more like to receive a subprime loan and Latinos were 2.2 times more likely to do so than their white counterparts," and that "the disparity in subprime loans between whites and African Americans and other minorities actually grows at an upper-income level and is greater to higher income African American homeowners than are lower income white homeowners."

Another more recent study from the National Community Reinvestment Coalition shows that the trends identified have not abated, and that, "discrimination is widespread in America. African American and predominantly elderly communities receive a considerably high level of low-cost subprime loans than is justified based on the credit risk of neighborhood residents."

All of these studies bear out a fact that the NAACP has known for years through our grassroots effort at increasing homeownership in our communities and through personal experiences. African Americans are disproportionately targeted by predatory lenders for subprime loans, and the results are incredibly destructive. The problem appears to be getting worse. It is because of the disparate and frankly injurious manner in which some financial institutions continue to deal with African American communities that the NAACP has at the national, state and local levels pushed for stronger anti-predatory lending laws.

In the interest of time, Madam Chairwoman, I am asking that two recent NAACP national resolutions dealing with predatory lending, which were included in my written testimony, be inserted into the record.

[The following information can be found on page 140 and 143 in the appendix.]

Chairwoman KELLY. So moved.

Mr. SHELTON. Thank you very much. I would call special attention to the resolution passed in February of last year which specifically States the NAACP's opposition to Federal preemption of State laws.

So why is the NAACP so opposed to the Federal preemption of State laws and specifically to the OCC's recent actions? Put simply, by preempting state and local anti-discriminatory lending laws, the OCC is effectively doing away with the all-too-few protections we have been able to put in place to address the scourge of predatory lending. The only way we can truly put a dent in the problems that result from predatory lending is to change the mortgage lending marketplace, so as to make predatory loans too risky, too expensive for lenders, and no longer good financial investments. We must take away the monetary incentives to make predatory loans.

It is true that historically national banks have been less likely to perpetuate predatory lending practices. This does not mean, however, that national banks and their subsidiaries do not participate in or profit from predatory lending. On the contrary, there are numerous cases in which national banks, their operating subsidiaries and their affiliates have clearly profited from predatory lending.

National banks, their subsidiaries and their affiliates profit from predatory lending practices in numerous ways, including making direct loans, buying predatory loans from brokers, investing in loan portfolios that contain predatory loans, and providing securitization services for trusts which contain predatory loans.

Because the Federal government has frankly done little to make it less profitable for banks to engage in predatory lending, or at least supporting predatory lending, several States have stepped in to protect their citizens. I must point out that all of these statutes were enacted only after research, intensive debate and negotiations, and many were made with local economic conditions and concerns in mind. Yet the OCC is exempting national banks and their subsidiaries from these protections, without offering any real alternative protections from predatory lending.

While the regulations, as we understand it, do offer a few protections, they are incredibly weak and will clearly not even begin to

be as effective against predatory lending as many of the State laws, including those in North Carolina, Georgia, New Jersey and New York, to name just a few.

Furthermore, the list of State laws that will be preempted by this new regulation is long and, in many cases, very vague. When closely scrutinized, it is clear that under the new regulation, the OCC intends to preempt national banks and their operating subsidiaries from hundreds and particularly thousands of consumer protections and anti-predatory lending laws. This means that instead of all 50 state attorneys general, all 50 State offices of consumer protection, and all the private attorneys who are bringing suits against banks under State laws, enforcement of very vital and necessary consumer protections and anti-predatory lending laws will be left up to the OCC's consumer advisory group, an office of 22 people located in Texas.

Thus, 22 people located in one office in one city in one state will be responsible for monitoring and enforcing against the predatory lending actions of thousands of financial institutions across the nation. The exact number of financial institutions of which these 22 individuals will be responsible is unclear. Suffice it to say, however, that according to the OCC, there are 2,100 national banks, and one of the largest, Wells Fargo, has 76 operating subsidiaries that engaged in consumer mortgage lending in May of 2002, the most recent data that we have available to us now.

In other words, rather than a multitude of regulators and watch dogs located throughout the nation in our communities monitoring the behavior of national banks and their subsidiaries, enforcement of anti-predatory lending laws will be left to a few individuals.

Thus, not only does the NAACP decry the evisceration of many of the State laws that are protecting our members and our communities from predatory lending, but we are also extremely troubled by the practical impact of this new regulation. The few laws that are left that protect us will, frankly, not be enforceable.

Predatory lending has ruined individual lives and communities and represents a real threat to our nation's continued economic well-being. As a result of predatory lending, millions of Americans across our nation have lost their homes and their primary source of savings. We should be taking more proactive steps to address this problem, and expanding on the initiatives advanced by the State laws, not exempting a whole class of financial institutions from state regulations that protect individual consumers.

As I said in the beginning of my testimony, predatory lending is clearly a civil rights issue, given the egregious way in which racial and ethnic minorities are targeted by some financial institutions for predatory loans.

Chairwoman KELLY. Mr. Shelton, could you please summarize it?

Mr. SHELTON. In summation, by putting these regulations in place, the OCC is setting a precedent to allow some national banks to continue to target racial and ethnic minorities and the elderly for their own monetary gain. This is contrary to the long-held view of the NAACP that the primary responsibility of government is to protect its citizens, all of its citizens, and not to exploit them in the gains of a few.

[The prepared statement of Hilary O. Shelton can be found on page 136 in the appendix.]

Chairwoman KELLY. Thank you very much.

I want to say that I applaud the efforts of you, Mr. Shelton and the NAACP; you, Mr. Hamilton and the AARP; and you, Mr. Belew, for reaching out and attempting to create some financial literacy on the part of your members. It is extremely important that people gain financial literacy, probably at an early age, because some of this predatory lending can be stopped if people only understand and can see clearly what it is that they are being charged.

If you graduate from high school and you cannot do percentages and you cannot figure out fractions, then you are not going to be able to understand if you get a housing loan. It is a serious problem and I really congratulate your three organizations for what you have done. I know that the ABA has done a lot of very good outreach in trying to educate people just on their own, and I know there are many other institutions, but you happen to be the people that are here in front of me today, and I do congratulate you for doing that kind of outreach.

I am going to ask really just one question. Comptroller Hawke asserted, and again said something to me on the telephone in our telephone conversation, that in terms of predatory lending that it is not the national banks that are the problem, but it is the unregulated institutions that are not impacted by these rules. I am wondering if you think Congress should consider legislation that is broader in scope, to try to address that kind of concern. You can just answer this, if you will, just with a yes or no response. Let's start with you, Mr. Shelton.

Mr. SHELTON. Yes, absolutely. As our banking institutions become much more complex, certainly broader, more protective policies need to be put in place for our consumers.

Chairwoman KELLY. Mr. Hammond?

Mr. HAMMOND. Madam Chairwoman, I am not sure I understood your question exactly.

Chairwoman KELLY. The question is that in terms of the predatory lending, it is really not the national banks that are a problem, but there are unregulated institutions out there that are not impacted by either the OCC rules or by some of the State rules. The questions now is do you think there should be a Federal effort to consider legislation that is broader than the OCC has actually done here to address these unregulated institutions.

Mr. HAMMOND. I guess in answer to your question, there are two parts. First of all, I am not sure that the first premise is exactly correct, that no national banks have been involved in any of this.

Chairwoman KELLY. I am basing this on what the Comptroller of the Currency said.

Mr. HAMMOND. Secondly, I think AARP has always considered that there should be a strong floor of Federal legislation on consumer protections, so we would support that certainly, but only a floor.

Chairwoman KELLY. Okay, thank you.

Mr. Belew?

Mr. BELEW. Ms. Kelly, it is difficult to say yes or no to that, and let me tell you why. I know around our tables we have debated this

endlessly because it is a scourge of the land. It should not be out there. It is very difficult, as we have seen in these various States, to concretely define exactly what you are going to prohibit. You might say flipping is bad, but then are you going to prohibit refis? I do not think the middle class would like that very much.

So my answer is, I understand that there will be some discussion. We have already had it from the Members today. We would like to be part of that discussion. I would simply urge caution that we not repeat on the Federal level the "catastrophe", my words, that happened in various States, because I do think harm was done to consumers when credit dried up.

Chairwoman KELLY. Thank you.

Ms. Thomas?

Ms. THOMAS. Yes, Madam Chairwoman, I think one point that needs to be made is that a lot of these lenders—it is not that they are not regulated, it is that they are not supervised or examined. They are subject to all the Federal laws that govern lending and protect consumers, but it may be difficult to find the resources to enforce those laws against those lenders. I think that needs to be one of the first steps, is to address better enforcement against those actors.

Chairwoman KELLY. Thank you.

Mr. Taylor?

Mr. TAYLOR. The short answer is yes. I disagree. They are not all regulated, subjected to the same Federal laws. Large national credit unions, private mortgage companies have no CRA obligation. They do not have any obligation to serve working class Americans. I think it is time to level the playing field with banks to bring those people into the equation and expand CRA. I know there have been a couple of bills in Congress recently to consider that.

The other thing, I would not accept the supposition that national banks are not part of the problem. You heard Ms. Williams note that they did a settlement recently in California with, I think, Providian Bank, in which they found some what would clearly be predatory lending practices. It was not the only institution they found. Furthermore, a number of the national banks are involved in purchasing these loans so they enable people who do the predatory lending loans by buying them and putting them on their books. That would be my answer.

Chairwoman KELLY. Thank you.

Mr. Yingling?

Mr. YINGLING. Yes.

Chairwoman KELLY. That was a short answer. Your answer is yes.

[Laughter.]

Well, I hope that the ABA will be interested in working with us, Mr. Taylor, Mr. Thomas and all of your groups. I hope that you will work with us if we consider legislation in that regard.

Mr. Hammond, did you have something further you wanted to say?

Mr. HAMMOND. Yes, ma'am, just a point of clarification. Did I understand you correctly at the beginning when you said that all written testimony would be included as a matter of record of this hearing?

Chairwoman KELLY. Yes, you did.

Mr. HAMMOND. Thank you.

Chairwoman KELLY. All written testimony will be a part of the record. We have made a lot of other things part of this record. This is an important hearing and I think that its purpose is well-served by the testimony of all of you here today.

The Chair notes that some Members will have additional questions. I certainly do. This panel will get those questions in writing, and the other Members may wish to submit their questions in writing. So without objection, the hearing record will remain open for 30 days for Members to submit written questions to the witnesses and to place the witnesses's responses in the record.

With that, I thank you very much for your time, your patience, and I appreciate your appearing before us today.

This hearing is adjourned.

[Whereupon, at 12:57 p.m., the subcommittee was adjourned.]

A P P E N D I X

January 28, 2004

Statement of Chairwoman Sue Kelly
Subcommittee on Oversight and Investigations
"Congressional Review of OCC Preemption"
January 28, 2004

Today, the Subcommittee on Oversight and Investigations will conduct a review of two regulations that were finalized earlier this month by Office of the Comptroller of the Currency (OCC). The regulations preempt state laws that currently apply to national banks, and they restrict the authority of states and other agencies to examine or take actions against these entities. When they take effect on February 12th, these regulations will effectively prevent a state from determining and enforcing its own laws.

Preemption of any state law is an extremely serious issue with significant consequences for all Americans. The preemption of state banking regulation is even more serious because it has critical implications for consumer protections and the overall dual-banking system, which has served our country well for decades. A decision of this magnitude requires considerable review by Congress to ensure that consumer protections are not being undermined and that the balance of the dual-banking system is not disrupted.

The OCC is tasked with interpreting Congressional intent, and in terms of these regulations, the intent of Congress is unclear. The correspondence of several dozen members of Congress from both sides of the aisle, however, demonstrates that Congress has many unanswered questions and concerns that need to be thoroughly reviewed before these changes are implemented.

As the Chairwoman of the Financial Services Subcommittee on Oversight and Investigations, I wrote the OCC on December 1, 2003 asking the agency to delay these rules until Congress can hold hearings to review the agency's proposal and signal our intent. The OCC went ahead and finalized these rules without this necessary review, an action that I believe demonstrates a lack of respect for Congress and this committee.

I am concerned that an agency tasked with interpreting the laws passed by the Congress has strayed from its obligations to protect consumers. The OCC is supposed to be an independent agency; its actions have led many of us to question whether they are also independent of the people's best interests.

Unfortunately, this is not the first time that Congress has had difficulty working with the OCC, which indicates to me that there may be larger systemic problems at the agency. Congress must, and will, take all necessary steps to ensure that the interests of the American people come first – even if it means a 'culture of change' at the OCC. The American people expect, and deserve, real leadership and accountability when an action could potentially jeopardize crucial consumer protections. We are going to see to it that consumers get these assurances.

It may have been the agency's decision to move forward without congressional review, but this Committee's ability to protect consumers and provide this oversight will not be inhibited. We will begin our investigation today, and it will continue until all questions are answered and the Committee determines an appropriate course of action. I have personally spoken with Comptroller Hawke, and he has promised to testify before the Committee when he returns from medical leave.

I also have asked Mr. Hawke to take the necessary steps to delay the implementation of these regulations until we complete our review. The Comptroller of the Currency is a Presidential-appointed and Senate-confirmed position, and these regulations should not be implemented without direct explanation from the Comptroller. This request presents the OCC with a tremendous opportunity to display to Congress and consumers that the agency takes this review seriously and is willing to address concerns with the regulations.

In terms of the substance of these new regulations, my colleagues and I hope many questions can be answered today. I recognize that we live in a different world today with an advanced financial services sector, in which companies utilize technology and other resources to offer better and less costly products and services. In principle, I also understand that there is a need for more uniformity in regulation, and that we need to investigate whether a patchwork of laws may also impede progress that is beneficial to the consumers. In fact, this Committee has held several hearings on reforms in insurance and securities regulation, with the intent that changes could be made by Congress through a legislative process. However, for a regulator to single-handedly preempt a state's ability to both determine and enforce laws without public debate or explicit direction from Congress is troublesome and careless. The American people deserve a voice in these decisions.

I am certain that many members have questions today specifically on the issue of predatory lending. While this is one of the significant laws preempted, I caution that we not focus solely on this issue, given the overreaching nature of these regulations – which appear to be much larger than just this one issue. I hope my colleagues in the Subcommittees on Housing and Financial Institutions continue their investigations into predatory lending to address these specific concerns.

I want to remind members – this hearing is to collect facts to see if Congress needs to further clarify its intent to the OCC. As usual, the committee five- minute rule will be observed.

I would like thank the witnesses for their attendance here today. I look forward to working with you on these important issues that are critical to the American people.

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Oversight and Investigations

January 28, 2004

"Congressional Review of OCC Preemption"

I want to begin by commending Chairwoman Kelly for holding the first congressional oversight hearing on the OCC's recently issued regulations setting forth standards for determining when State laws can be applied to the operations of national banks.

Our dual system of national and State bank chartering is a unique feature of the U.S. financial marketplace, and has served the American economy and American consumers well for almost 200 years. Since the inception of the dual banking system, tension has periodically flared between Federal and State authorities over the proper allocation of responsibility for overseeing the activities of national banks. The regulations issued in final form by the Comptroller earlier this month, after a period for notice and comment, are the latest chapter in that long-running debate.

While most of the attention in the media and elsewhere has focused on the OCC's pre-emption of predatory lending laws that an increasing number of states and municipalities have enacted in recent years, the regulations are in fact much broader in scope, and raise issues that go to the heart of the dual banking system, including the following:

-- Should institutions that are chartered by the Federal government and operate on a nationwide basis be required to comply with laws passed by State or local governments that address core bank functions such as lending and deposit-taking?

-- Should the authority to enforce Federal and State laws against national banks reside exclusively with the OCC – except as otherwise provided by Federal law – or do State Attorneys General and other State agencies have a role to play?

-- Does the application of uniform Federal standards to lending and deposit-taking – and the centralization of authority for enforcing those standards – promote the safety and soundness of national banks and yield benefits for their customers?

In my view, the OCC regulations represent a thoughtful attempt to codify and harmonize past legal precedents, and there are many, and regulatory guidance into a coherent framework for resolving conflicts between Federal and State laws as they apply to national banks.

Oxley, page two
January 28, 2004

The regulations largely conform the pre-emption standards applicable to national banks to those that have long been applied to Federally chartered thrifts by the Office of Thrift Supervision, and to Federal credit unions by the National Credit Union Administration.

With respect to the charge that the OCC's regulations leave customers of national banks exposed to abusive lending practices, it should be noted that there is a decided lack of evidence that national banks have engaged in such practices, which tend to be centered instead in non-Federally regulated mortgage and finance companies that remain fully subject to state and local anti-predatory lending laws.

Moreover, for those national banks that **do** engage in abusive or unscrupulous tactics, the OCC's regulations contain new standards prohibiting institutions from making loans based predominantly on the foreclosure value of the collateral and without regard to the borrower's ability to repay, and from engaging in "unfair and deceptive trade practices" as defined in the Federal Trade Commission Act. We will hear from opponents of the OCC's regulations at today's hearing who question the agency's commitment to enforcing its new anti-predatory lending standards, and argue that consumers are better served by a regime in which national banks must answer to both Federal and State authorities.

In closing, let me again commend Chairwoman Kelly for tackling this difficult issue, and for vigorously asserting this Committee's oversight prerogatives to ensure that the Federal agencies within our jurisdiction act in the public interest.

Let me also welcome all of our witnesses to today's hearing, particularly OCC Chief Counsel Julie Williams, who is here pinch-hitting for Comptroller Jerry Hawke as he prepares to undergo surgery later this week in New York. We wish the Comptroller a speedy recovery, and look forward to continuing this Committee's dialogue with him on this and other issues of concern upon his return to duty in March.

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COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
CHAIRMAN, SUBCOMMITTEE ON ECONOMIC DEVELOPMENT, PUBLIC BUILDINGS AND EMERGENCY MANAGEMENT

COMMITTEE ON GOVERNMENT REFORM

COMMITTEE ON FINANCIAL SERVICES
VICE CHAIRMAN, SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

COMMITTEE ON STANDARDS OF OFFICIAL CONDUCT

Steven C. LaTourette
Congress of the United States
14th District, Ohio

Statement of Congressman Steven C. LaTourette
January 28, 2004
Subcommittee on Oversight and Investigations

Chairwoman Kelly, thank you for holding this hearing today on an issue of vital importance to our nation's banking system. I also want to applaud the spirit in which you have called this hearing, namely to address the concerns voiced by many with regard to the sweeping use of regulatory power displayed by the Comptroller of the Currency in the absence of Congressional review. There is no doubt that predatory lending, a topic which I'm sure will be discussed at length today, is a tremendous problem in our country that frequently harms those homebuyers with less-than-exemplary credit histories. I've worked with a number of constituents who have fallen prey to unscrupulous lenders, interestingly from both small, fly-by-night operations, and also by large, well-known institutions.

The issue at hand today goes directly to the core of our dual-banking system. The rules issued by the OCC have drawn a clear line in the sand with regard to the nature of federal versus state-chartered banks. As is always the case when the Supremacy Clause and the concept of Federalism are drawn into the fray, both sides have offered passionate, compelling, and often acrimonious opinions in this debate. Viewing the issue today, first and foremost I must rely on the development and evolution of our financial services industry, and the laws and precedents the Congress and courts have passed to define the regulatory powers held by each individual state and the federal government. In the 140 years since passage of the National Bank Act, our judicial system has repeatedly held that states may not impose regulations that supercede or conflict with federal banking laws. In numerous challenges, the OCC has successfully demonstrated that its authority to set regulatory floors and ceilings with regard to national banks is protected by the Constitution.

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Another argument we will hear today is one I'm quite familiar with – that creating a national standard harms consumers and takes away the ability and right of the states to patrol and protect their citizens. As I worked to develop the identity theft provisions included in the Fair and Accurate Credit Transactions Act last year, this was one of the debates I faced. In the end, I concluded that because identity theft is a crime that so often transcends state boundaries and jurisdictions, American consumers would be best protected and be provided the most effective tools to combat identity theft with a national standard. Also, the consistency provided with a national standard allows consumers to be protected from this crime no matter where they live. In the debate over predatory lending, many of the same parallels and conclusions can be drawn. The supervisory role of the federal banking regulators can work to ensure that all federal consumer protection standards are enforced. In addition, the uniformity provided by a national standard in this case could permit consumers to shop for the lowest rate and purchase a home anywhere throughout our country, without fear of predatory lenders.

All of that said, the OCC needs to make sure that the standards it enforces are world-class and truly do afford the best protection for American consumers. While there are many compelling arguments to suggest that a national standard is appropriate in this case, there is obviously much to be said for the ability of individual states to determine what is best for their citizens, and that should not be ignored. Our system of dual banking has endured the test of time, and has given American consumers more and better options to handle their finances. The actions taken by the OCC are yet another volley in this system of checks and balances, a system that has functioned effectively since the days of Lincoln. While I tend to believe that its actions will not affect the doomsday scenarios envisioned by many opposed to this preemptive rule, it is critical for Congress to exercise its oversight responsibility on such a far-reaching change in regulation to ensure that any national standard is in the best interest of American consumers, and void of the politics that tend to tarnish sound policy discussions.

Testimony of

Joe Belew

President, Consumer Bankers Association

on

"Congressional Review of OCC Preemption"

before the

Subcommittee on Oversight & Investigations

of the

Financial Services Committee

of the

United States of America

On

January 28, 2004

Madam Chairman and members of the subcommittee, my name is Joe Belew. I am President of the Consumer Bankers Association, a national trade association representing banks nationwide. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets. The vast majority of our members are national banks. At CBA, in my role as President of the association, I interact daily with the heads of the retail banking operations—the men and women who are responsible for many of the lending and deposit taking activities that are subject to the OCC's actions. I am very pleased to have the opportunity to share with you CBA's views on this subject—a subject that is so important to our member institutions. For the record, I am also attaching CBA's comment letter to the OCC in response to the preemption proposal.

We strongly support the OCC's regulations that define the applicability of state laws to the activity of national banks and their operating subsidiaries. Increasingly, in recent years, national banks have been facing the intrusion of state and local statutes and regulations on their federally created powers. The courts and the OCC have uniformly and consistently resolved each such instance by reaffirming the supremacy of the national bank powers and the constitutionally based preemptive effect of the National Bank Act. But there has remained a need for greater uniformity and predictability for the banks operating in multiple jurisdictions nationwide, and these regulations will provide that helpful guidance.

The final regulation clarifies the extent to which national banks are subject to state laws. The rule identifies the types of state laws that are preempted by the National Bank Act, as well as the types of state laws that are not preempted. Reflecting the history of judicial rulings, the types of laws that are preempted include those laws regulating loan terms, imposing conditions on lending and deposit relationships, and requiring state licenses. These are types of laws that create impediments to the ability of national banks to exercise powers that are granted under federal law. Incidentally, they are virtually identical to the types of laws preempted for federally chartered thrifts by the regulations of the Office of Thrift Supervision. The OTS authority has been in place for many years.

The OCC regulation is clear that there are many state laws that are not preempted by the National Bank Act. These are laws that do not regulate the manner or content of the business of banking authorized for national banks, but rather establish what the OCC calls the "legal infrastructure" of that business. These generally include laws on contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes and torts. The agency has also made it clear that any other law it determines would only incidentally affect national banks' lending, deposit-taking, or other operations would not be preempted.

It is important to recognize that the agency is not breaking new ground by issuing this rule. The regulation is based on Supreme Court precedent dating back to 1869—135 years—consistently holding that national banks were designed to operate under uniform, federal standards of banking operations nationwide. By codifying over a century of court decisions and OCC interpretations, the agency is clarifying the law and responding to numerous questions about the extent to which various types of state laws apply to national banks and their operating subsidiaries. By a separate rulemaking, the OCC is also clarifying the authority of state or other agencies to take actions against national banks and their operating subsidiaries. These rules will give national banks the uniform and predictable standards that permit them to serve their customers in diverse markets nationwide.

Nor is it correct to accuse the OCC by its actions of threatening the dual banking system. Many states, including Georgia—which was the subject of the OCC's recent preemption determination-- have "parity" or "wild card" laws that give state chartered institutions the same coverage as national banks and federally chartered thrifts. Therefore, the states can and do protect their state chartered institutions if they believe such protection is warranted. Furthermore, as the Comptroller has pointed out, it is up to the states to determine whether they believe a separate state code is appropriate to continue to operate as a laboratory for innovation, rather than emulation.

Because so much attention has been directed at the important area of predatory lending and the recent enactment of state laws to address the problem, a charge has inevitably been leveled at the OCC that its actions will leave consumers vulnerable, by sweeping away these state protections and leaving nothing in their place. On the contrary, the OCC is second to none in its regulation and enforcement of consumer protection laws. National banks are subject to the whole array of federal consumer protection laws, from the Truth in Lending Act and the protections accorded by the Home Ownership and Equity Protection Act to the anti-discrimination provisions of the Equal Credit Opportunity Act and the Fair Housing Act. But the OCC has additional tough guidelines in place that are unique to national banks, spelling out in detail what rules the banks and their operating subsidiaries must follow in order to ensure that all national bank lending, deposit taking, and other activity remain above reproach. We have attached a list of the many consumer protection laws to which national banks must stringently adhere.

As part of the preemption regulation, the agency has also added two additional provisions applicable to national banks, designed to provide an additional layer of protection for consumers. One provides that a national bank may not make consumer loans based predominantly on the foreclosure or liquidation value of the borrower's collateral. This places a total ban on any lending by a national bank that does not take into consideration the borrower's ability to repay, a ban on loans made with the expectation of profiting from foreclosure. The second provision added to the new rules states that a violation of section 5 of the FTC Act, which protects consumers against unfair or deceptive acts or

practices, is a violation of the National Bank Act. This ensures that the OCC can employ its enforcement authority against banks that engage in any unfair or deceptive practices as defined by that act.

National banks are leaders in responsible lending. In fact, all the evidence suggests that national banks and their subsidiaries are not a principal source of concern when it comes to any abusive or predatory practices. For example, an *amicus* brief filed last year by 22 state Attorneys General in the U.S. District Court for the District of Columbia stated, "Based on consumer complaints received, as well as investigations and enforcement actions undertaken by the Attorneys General, predatory lending abuses are largely confined to the subprime mortgage lending market and to non-depository institutions. Almost all the leading subprime lenders are mortgage companies and finance companies, not banks or direct bank subsidiaries."[1] The object of the OCC's comprehensive rules and guidelines—along with the additional standards being adopted as part of this regulation-- is to ensure that national banks remain the gold standard in responsible lending.

Our experience at CBA supports the assertion that national banks also take proactive steps to protect consumers from abusive practices of others. One universally recognized

[1] National Home Equity Mortgage Association v. Office of Thrift Supervision, Brief of Amicus Curiae State Attorneys General in Opposition to Plaintiff's Motion to Summary Judgment and in Support of Defendant's Motion for Summary Judgment, Civ. Act. No. 1:02CV02506 (GK), US Dist. Ct, D.C., March 21, 2003 (Emphasis added)

way to shield consumers is to give them the education in financial services that permits them to recognize and avoid bad practices. As Federal Reserve Board Chairman Alan Greenspan said, "Regulators, consumer advocates, and policymakers all agree that consumer education is essential in the quest to stem the occurrence of abusive, and at times illegal, lending practices." National banks have demonstrated an ongoing commitment to educating customers as a means of protecting them from predatory practices

For three years, we have surveyed our member banks to determine how involved they are in financial literacy efforts, as a measure of their sense of responsibility to the communities they serve. The most recent survey showed that 98% of the respondents-with the majority being national banks-sponsor financial literacy programs or partner on financial education initiatives.

CBA's *Survey of Bank-Sponsored Financial Literacy Programs* shows a significant increase, from 60% to 72%, in bank programs aimed at helping consumers avoid abusive or predatory lending practices such as flipping, avoiding unscrupulous lenders, excessive interest rates, or payday loans. Thirty-eight of 53 respondents stated that their banks offered programs targeting issues such as flipping, avoiding unscrupulous lenders, excessive interest rates or payday loans.

Additionally, 96% of banks offer mortgage and home ownership counseling, typically in connection with an affordable mortgage program, which is offered by 93% of responding banks. With 73%, credit counseling is mandatory to qualify for such programs. In addition, 37% of the 2003 respondents indicated that the institution had a foreclosure prevention program in place. This commitment to financial literacy is actively encouraged by the OCC as a means of combating predatory practices.

The vast array of laws and guidelines to which national banks are subject is very effective. Because of the comprehensive examination oversight to which national banks are subject, the OCC can find and stop problems before they occur. If anything slips through the net, the agency can and will take enforcement action—everything from cease and desist orders to monetary penalties, which can be very punitive. The OCC has a strong track record of taking action on the rare occasion it discovers national banks that may be engaged in abusive practices. In several recent cases, the agency has imposed substantial monetary penalties on institutions. But the OCC's scrutiny in this area goes back for a number of years. At a CBA conference, June 5, 2000, for instance, OCC Special Counsel Julie Williams stated: "We plan to use our supervisory powers -- through our safety and soundness, fair lending, and consumer compliance examinations; our licensing and chartering process; and individual enforcement actions -- to address any potential predatory lending concerns that might arise in national banks and their subsidiaries." National banks have long been on notice that the OCC's examination and enforcement in this area is rigorous.

The OCC has also sought cooperation from the states where there may be allegations of wrongdoing by national banks or their operating subsidiaries and established special procedures for expedited referrals of consumer complaints from State Attorneys General and banking departments. In this way, the state law enforcement officers can pass on complaints to the OCC for follow up, and preserve their resources to enforce the state laws against the predatory lenders and other bad actors.

National banks benefit from being subject to a uniform set of rules that do not vary from state to state. Banks today operate across many state lines, permitting them to serve the needs of an increasingly mobile society. A single set of rules also permits them to provide economies of scale and streamlined services in a cost-effective way. As heavily regulated financial institutions, they can provide the quality products and services that can, through competition in the marketplace, drive out the bad actors that we all are trying to eliminate—the marginal and high-cost operators. But their ability to do so is severely hampered by the laws, regulations, and ordinances adopted in each jurisdiction. Since states do not have the kind of on-going scrutiny of unregulated lenders and brokers that the OCC has over national banks, the laws are often overbroad—driving out the good with the bad. Forcing national banks to comply with all these myriad, often conflicting, state laws, would make it difficult if not impossible for national banks to operate in the uniform and efficient manner envisioned in the National Bank Act.

In conclusion, we strongly support the OCC's regulations clarifying the applicability of state laws to the activity of national banks and their operating subsidiaries. Its actions are in accord with the letter and spirit of the National Bank Act, as it has been consistently interpreted by over a century of court opinions; permitting national banks and their operating subsidiaries efficiently to serve the needs of their customers nationwide without being hobbled by a hodge-podge of well-intentioned but disruptive laws in every locality. The extensive consumer protection laws to which national banks and their operating subsidiaries are subject, together with strong leadership and rigorous oversight by the OCC and its examination force, will ensure that national banks continue to serve consumers well in the future.

Once again, thank you for this opportunity to share our views.

Federal Consumer Protection Laws that Are Enforced on National Banks

- Federal Trade Commission Act
- Truth in Lending Act
- Home Ownership and Equity Protection Act
- Fair Housing Act
- Equal Credit Opportunity Act
- Real Estate Settlement Procedures Act
- Community Reinvestment Act
- Truth in Savings Act
- Electronic Fund Transfer Act
- Expedited Funds Availability Act
- Flood Disaster Protection Act
- Fair Housing Home Loan Data System
- Credit Practices Rule
- Fair Credit Reporting Act
- Federal Privacy Laws
- Fair Debt Collection Practices Act
- Consumer Leasing Act
- Fair Credit Billing Act
- CCPA Garnishment Restrictions
- Check Clearing for the 21st Century Act
- OCC anti-predatory lending rules in Parts 7 and 34
- OCC rules imposing consumer protections in connection with the sales of debt cancellation and suspension agreements
- OCC standards on unfair and deceptive practices
- OCC standards on preventing predatory and abusive practices in direct lending and brokered and purchased loan transactions

October 3, 2003

John D. Hawke, Jr.
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E St., S.W.
Public Information Room, Mailstop 1-5
Washington, D.C. 20219

Re: Docket No. 03-16: Notice of Proposed Rulemaking on preemption of state laws.

Dear Mr. Hawke:

The Consumer Bankers Association[2] (CBA) is pleased to have the opportunity to submit these comments in connection with the proposed rulemaking concerning preemption of state laws, involving amendments to Parts 7 and 34 of the OCC Regulations.

CBA supports wholeheartedly the thrust and direction of the proposal. Over more than a century, and especially in recent decades, it has become abundantly clear that the constitutionally preemptive effect of the National Bank Act and other federal laws relating to the powers of national banks cannot be undercut by state law that interferes with the exercise of those powers. A virtually unbroken line of judicial decisions and OCC interpretations has solidified the notion that national banks must be able to exercise the full range of federally established banking functions, without interference or burden from state regulatory and visitorial regimes.

With legislative and regulatory activity in the states increasing in recent years, it has been necessary for the courts and the OCC to address a series of instances in which state law arguably crosses the federalism line and intrudes on the protected powers of national banks. The proliferation of these challenges, arising not only from regulatory

[2] The Consumer Bankers Association is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments, deposits and delivery. CBA was founded in 1919 and provides leadership, education, research and federal representation on retail banking issues such as privacy, fair lending, and consumer protection legislation/regulation. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

activity in fifty states, but from countless municipal and other local government activities as well, underscores the need for uniform ground rules and oversight for national banks. While the courts and the OCC have regularly reaffirmed the supremacy and independence of national bank powers, the pattern has been one of *ad hoc* determinations, with uncertainty on all sides until the particular state-federal friction has been resolved. And since the preemptive effect of federal law is constitutionally based, in a sense none of these determinations makes new law, but rather each is simply declaratory of the supremacy clause mandate.

Against this background, we understand that the OCC's intent in the proposed rulemaking is to provide clearer and more comprehensive guidance as to the range and scope of federal preemption regarding national bank powers. CBA strongly supports that objective. OCC guidance in this respect will provide helpful reassurance, uniformity, and predictability to bankers, regulators, and the public at large, on the impact of national bank powers and the boundaries for state-law applicability to those banks. In the process, this rulemaking would help equalize and balance the positions of federal thrift institutions under OTS and NCUA oversight, and national banks under OCC supervision.

The underlying issue is not whether state regulation is better or stronger than federal, or vice versa. It is, rather, whether national banks are able to operate and compete in national markets in accordance with federal law and federal supervision, without also being subjected to a flood of differing state and local laws and regulations that create redundancies, inefficiencies, compliance costs, and competitive disadvantages for those national banks. State chartered financial institutions must of course comply with state law, but those state institutions are not subject to the overlay of federal law and supervision that applies specifically to national banks. National banks, in turn, cannot effectively implement their federal charter powers under a blanket of additional, duplicative – and stifling – state and local regulation. In fact, for national banks conducting business across state lines, it is not a single blanket of state law, but potentially fifty – and many more when local jurisdictions are considered.

This is hardly to say that national banks are, or are asking to be, unregulated or free to engage in unscrupulous practices. The body of federal law that empowers national banks also orders and restrains bank operations for the protection of bank customers, investors, and the public at large. All of the federal consumer financial services laws, such as TILA, ECOA, and TISA, apply fully to national banks, as does the general proscription on unfair or deceptive practices under the FTC Act. The OCC has articulated substantial regulatory guidance on permissible and proscribed practices for national banks in all areas of their operations. No example is more current than the OCC guidelines relating to predatory lending, and incorporated in this rulemaking.

Most importantly, every national bank (and its subsidiaries) is subject to close scrutiny of its activities through the bank examination process, and the OCC has clearly indicated its ability and willingness to act against banks that exceed the bounds of appropriate conduct. There is no vacuum of federal law or oversight relating to the protection of national bank customers that needs state law to fill it.

We do not understand the current proposal to be an effort by the OCC to raise the bar of federal preemption, or to displace state law more broadly than precedents and tradition dictate. Rather it provides more bright-line guidance, in advance, as to the scope of the federal preemption. The result will be more certainty and consistency in the application of preemption principles, and less need for ad hoc challenges that are wasteful, time consuming, and inefficient.

"Field" vs. "conflict" preemption.

CBA concurs with the OCC suggestion that mortgage lending powers under Part 34 of the regulations should be treated as a matter of "field" preemption. The real estate lending authority for national banks and their subsidiaries derives from a separate and discrete statutory source (NBA § 371), and the legal framework for such lending has been extensively developed through federal statutes and agency regulations, including extensive guidance from the Federal Reserve Board, HUD, and the OCC itself. There is no need or justification to retain any significant state regulatory or visitorial role with respect to that aspect of national bank operations.[2]

For the proposed revisions in Part 7, which cover a wide waterfront of national bank operations from credit cards to deposit accounts to investment services, it is extremely helpful that the proposal lists the types of state laws that would be subject to preemption in each of the categories addressed (deposit taking, lending, other activities). It is justifiable, we believe, to state the preemptive effect of federal law in terms of general categories of state law, without the need to examine the details of each state initiative and to assess the degree-of-conflict it presents. The real conflict, obstruction or burden of state law arises not so much from the impact of any single state law, but rather from the possibility – indeed the likelihood – that an endless variety of different and irreconcilable homegrown regulations would emerge in the states, confronting national banks with an impenetrable morass of idiosyncratic state laws. For national banks operating countrywide or regionally, the burden of complying with that aggregate of differing state laws is the real "conflict" and the real justification for preemption.

We suggest several adjustments to the lists of state laws preempted in connection with lending transactions [§ 7.4008(c)(2)]. The list might explicitly include state laws dealing with **non-interest fees and charges**, since these are inextricably related to the bank's pricing of its credit products.[3] The lists ought also to include the **collection of**

[2] We understand that, under the proposal, even when field preemption applies, there is a residuum of state law that will continue to apply to national bank operations as part of the "infrastructure" of state law applicable generally to business activity in the state. Proposed § 34.4(b).

[3] We appreciate that OCC may understand that non-interest fees are dealt with in 7.4002, and therefore do not need a separate preemption statement.

debts in default; there is no reason to preserve for national banks the powers to market, price, book, and service loans, without also protecting their ability to follow the collection trail to its conclusion after default.

The preemption boundaries for preempted and retained ("incidental") state laws

We recognize that a stream of *ad hoc* judicial or administrative determinations about preemption, arising out of concrete examples of conflict between federal and state law, can be a frustrating and time-consuming process, as each challenge is resolved on its specific circumstances. But at least there is, usually, a definitive answer to that particular preemption issue. A comprehensive, across the board, regulatory statement on preemption of state law is inherently attractive, and CBA supports the proposed rulemaking for exactly this reason. But there is a degree of risk in shifting to a broader, more generic regulatory approach – as the pending rulemaking does. Each section of the proposed regulatory amendments lists, by "type," the kinds of state laws that are preempted, and others that are generally <u>not</u> preempted. Each of these lists is stated as a set of very broad categories. There is the potential that these two lists will be read in parallel, and as mutually exclusive, where we do not believe this is the OCC's intent; state law that provides "infrastructure"and "merely incidental" regulation of business activity will still need to be evaluated against the traditional preemption criteria. We therefore suggest it may be preferable to delete the broad categorical lists of state laws that are not preempted, lest the lists themselves, and the relationships between them, become the focus of preemption challenges. Alternatively, to provide greater certainty and predictability, the OCC might consider elaborating on the scope of these categories, either in the regulation proper or in authoritative interpretational material related to it.

Predatory lending policy

CBA strongly supports the proposed statements concerning asset-based lending in sections 7.4008(b) and 34.3(b). We urge the OCC, when interpreting this language, to keep in mind that there are sophisticated and streamlined credit products in the market, such as "low-doc" and "no-doc" loans, where income may not be considered directly, in order to serve the convenience and needs of applicants with good credit. These products are not likely to raise the predatory lending concerns that are addressed in the proposal.

We would be pleased to discuss any of these matters further with you or the OCC staff, and we thank you for considering our views.

Sincerely

Steven I. Zeisel
Senior Counsel

Ralph J. Rohner
Special Counsel

WRITTEN STATEMENT

OF

W. LEE HAMMOND

MEMBER, AARP BOARD OF DIRECTORS

FOR THE HEARING ON:

"CONGRESSIONAL REVIEW OF OCC PREEMPTION"

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

JANUARY 28, 2004
2128 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C.

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Good morning Chairman Kelly, Ranking Member Gutierrez, and Members of the Subcommittee on Oversight and Investigations. My name is W. Lee Hammond. I am a member of AARP's Board of Directors.

I appreciate this opportunity to offer AARP's assessment of the Office of the Comptroller of the Currency's (OCC) recent action to preempt the applicability of state laws to national banks and their state chartered, non-bank, operating subsidiaries.[1] While the recent rulemaking by OCC broadly preempts state laws affecting virtually all aspects of national bank and operating subsidiary activities, including deposit-taking, consumer lending and real estate lending, I have focused my testimony on the rules' impact on state laws and enforcement actions designed to stop predatory mortgage lending, AARP's primary area of focus in recent years.

We are very concerned that the OCC has both exceeded its authority and has minimized the breadth of the problem of predatory mortgage lending in its rule to substitute a single substantive regulatory provision for the broad panoply of protections that currently exist under state anti-predatory mortgage lending and unfair, deceptive acts and practices laws. In so doing, the OCC is undermining state efforts to protect consumers and thereby taking action that is injurious to the public interest. AARP believes that Congressional action is necessary to protect consumers from predatory mortgage lending.

My testimony will focus on the following areas:

- National banking laws do not afford unfettered preemption authority over activities of national banks.
- State predatory lending laws are authorized by Home Ownership and Equity Protection Act (HOEPA).
- Overbroad preemption of all state consumer protection laws is an unwarranted intrusion into the exercise of legitimate state powers and injurious to the public interest.
- Preemption invades and purports to restrict express powers of judicial visitation over national banks.
- Operating subsidiaries of national banks are subject to state consumer protection laws and visitorial powers.

[1] See Final Rule on Visitorial Powers, 12 CFR Part 7, 69 Fed. Reg. 1895 (January 13, 2004); Final Rule on Preemption, 12 CFR Parts 7 & 34, 69 Fed. Reg. 1904 (January 13, 2004) "Generally, the rule provides that state laws do not apply to national banks [and their operating subsidiaries] if they obstruct, impair, or condition a national bank's exercise of its federally-authorized lending, deposit taking, and other powers." OCC Bulletin, OCC 2004-6.

Background

Throughout the past decade, AARP has been engaged in a range of activities targeted at curbing the growth of predatory mortgage lending in this country. AARP actively participated in negotiations leading to the passage of the Home Ownership and Equity Protection Act; participated with representatives of the mortgage industry in HUD sponsored negotiated rule-making under Section 8 of the Real Estate Settlement Procedures Act (RESPA); and has engaged in extensive discussions with consumer and industry representatives aimed at broad based mortgage reform. In these discussions, AARP has expressed the need for changes in the nation's federal laws to address abusive lending practices, and has proposed measures that would offer substantive protections against predatory mortgage lending. During this time, the number of victims of predatory lending, many of whom have come to AARP, has grown dramatically. In 1998 and 2000 HUD, the Federal Reserve Board, and the Treasury Department issued extensive reports defining predatory mortgage lending, chronicling its established patterns and its continued growth.[2] AARP has also supported federal legislative efforts to respond to these reports and stem the tide of predatory mortgage lending.

In 1999, consumers, government officials, and industry representatives in North Carolina worked together to pass the first state bill to address predatory mortgage lending. AARP, the National Consumer Law Center, and Self-Help Credit Union drafted a model bill based on the North Carolina law, that established a starting point for further state legislative advocacy. From these seeds, at least 15 other states enacted predatory mortgage lending laws or regulations. These state laws and regulations were designed to avoid preemption problems by avoiding rate and fee setting and by using the HOEPA model.

It is against this backdrop that AARP addresses the OCC's action that preempts the application of state laws to national banks and their operating subsidiaries. AARP believes that OCC's action will expose older borrowers to intensified predatory behavior, equity stripping and foreclosures.

The National Banking Laws Do Not Afford Unfettered Preemption Authority Over Real Estate Lending by National Banks [and their operating subsidiaries]

Despite the OCC's assertion that there are virtually no limitations on its exclusive authority to regulate the deposit-taking, consumer lending and real estate lending activities of national banks, for nearly 200 years Congress[3] and the judiciary[4] have clearly imposed

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[2] *See* Federal Reserve Board and U.S. Department of Housing and Urban Development *Truth in Lending Act and the Real Estate Settlement Procedures Act: A Joint Report* (July 1998); U.S. Department of Housing and Urban Development and U.S. Department of Treasury *Curbing Predatory Home Mortgage Lending: A Joint Report* (June 2000).

[3] Congressional action over the course of the past century has supported the application of state laws to national banks. Recognizing the healthy competition and innovation of the dual banking system, Congress has repeatedly acted to maintain equal powers for and equal treatment of state and national banks. Examples include Congressional action providing FDIC coverage to both state and national banks; allowing national banks the same intrastate

limitations on this activity and have made national banks subject to a variety of state laws. More recently, in 1994, Congress took action that plainly instructed the OCC that it did not have the unfettered authority to preempt the field with respect to national bank powers. In the Interstate Banking and Branching Efficiency Act, 12 U.S.C. § 36, Congress explicitly stated that state laws apply to national bank branches located in that state. This provision makes clear that there is no intent on the part of Congress to afford unfettered preemption of state law as to national banks.

> Law applicable to national bank branches. (A) In general. The laws of the host State regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches shall apply to any branch in the host State of an out-of-State national bank to the same extent as such State laws apply to a branch of a bank chartered by that State. . .[5]

There are only two exceptions to this rule: (1) when federal law by its own terms preempts the state law; and (2) when a state law has a discriminatory effect on national banks, as determined by the OCC. In taking this action, Congress made clear the very limited preemption authority of the OCC.

Interpretive Letter 674, issued by the OCC in 1995, expressed the OCC's view of the limitations on its preemption authority. Through this Letter, the OCC acknowledged the general rule that states have concurrent powers with the federal government on banking matters and that state law will be "presumed valid unless it conflicts with federal law, frustrates the purpose for which the national banks were created, or impairs their efficiency to discharge the duties imposed upon them by federal law."[6] Moreover, the OCC's painstaking and particularized listing of preempted laws in its annual description of permissible activities for national banks reinforces the principle that preemption is appropriately analyzed on a case-by-case basis, not through field preemption.[7] The OCC's newly adopted standard significantly lowers the bar, to the detriment of consumers.

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branching ability as their state counterparts; imposing the same reserve requirements on state FDIC insured banks as are imposed on national banks, and giving state banks parity with national banks regarding usury limits.

[4] As recently as 1996, the U.S. Supreme Court, in holding that a state may not "forbid, or impair significantly, the exercise of a power that Congress explicitly granted" to national banks, took pains to clarify that, "to say this is not to deprive States of the power to regulate national banks, where. . . doing so does not prevent or significantly interfere with the national bank's exercise of its powers." *Barnett Bank v. v. Nelson,* 517 U.S. 25, 33 (1996). See also, *National Bank v. Commonwealth,* 76 U.S. (2 Wall.) 353, 362 (1870) ("national banks are governed in their daily course of business far more by the laws of the State than of the nation. . . . It is only when State law incapacitates the [national] banks from discharging their duties to the federal government that it becomes unconstitutional"); *Atherton v. FDIC,* 519 U.S. 213, 222 (1997) (as a general principle, "federally chartered banks are subject to state law").

[5] 12 U.S.C. §36(f)(1)(A).

[6] OCC Interpretive Letter No. 674, June 9, 1995; 1995 OCC Ltr. 73 at 8-9.

[7] *See*, OCC's 2002 Activities Permissible for a National Bank

State Predatory Lending Laws Are Authorized by HOEPA and Are Necessary To Protect Consumers

AARP believes that state predatory lending laws are consistent with the purposes and objectives of Congress. Federal statutes such as the Truth-in-Lending Act and HOEPA have established the Congressional intent and purpose of eliminating abusive and predatory lending practices of all lenders including national banks. HOEPA establishes a category of high cost real estate loans and restricts the activities of mortgage lenders in connection with those loans. As a result of Congress' imposition of substantive restrictions on abusive high cost loans and affirmative invitation to the states to enact broader and stricter laws, national banks and other HOEPA lenders are now subject to more protective, state-enacted versions of HOEPA.

> The provisions of section 1639 of this title do not annul, alter, or affect the applicability of laws of any State or exempt any person subject to the provisions of section 1639 . . . from complying with the laws of any State, with respect to the requirements for [high cost] mortgages, except to the extent those State laws are inconsistent with any provision of section 1639 . . . and then only to the extent of the inconsistency.[8]

The Conferees concluded that "Loans that do not meet the triggers will continue to be regulated . . . by other applicable laws."[9] Congress has thus made clear that HOEPA and its state progeny legitimately restrict the activities of any high cost lender, including a national bank.

Confronted with growing complaints about abusive lending practices against their citizens, and with homeowners losing their homes to foreclosure, state legislatures and regulatory bodies seized upon the authority granted them by Congress under HOEPA to expand its protections.[10] In response to our members' own experiences with abusive mortgage lending practices, AARP developed a national campaign. AARP's campaign includes a three-pronged approach to stop predatory lending through education, litigation and legislation.

AARP has actively engaged in state legislative efforts to pass anti-predatory mortgage lending laws in North Carolina, New York, Massachusetts, Pennsylvania, Georgia, Ohio, California, Colorado, Kentucky, New Jersey, Florida, South Carolina, Arkansas, Oklahoma, New Mexico and Illinois. AARP continues to work for passage of such laws in five additional states: Arizona, Indiana, Michigan, Minnesota and Tennessee.

These legislative efforts track HOEPA, while providing stronger consumer protections. These laws create a class of loans (high cost), like HOEPA, that are more likely to be abusive or

[8] 15 U.S.C. §1610(b).
[9] H.R. Conf. Rep. No. 652, 103d Cong. 2d Sess. 147, 159 (1994).
[10] *See. e.g.*, Brief of *Amici Curiae* in Support of Appellee OBRE, *Illinois Association of Mortgage Brokers v. OBRE*, No. 02-1018 (U.S. Court of Appeals for the 7th Circuit).

predatory. Lending practices that are restricted or limited regarding these high cost loans are the same as those included in HOEPA. HOEPA and the state predatory lending laws place limitations and/or restrictions on practices such as loan flipping, asset-based lending, and packing of excessive fees and costs (e.g., single premium credit insurance) in the principal amount of the loan. The OCC has itself acknowledged the need for national banks to guard against these abusive and predatory lending practices.[11]

AARP is concerned, however, that rather than recognizing the important contribution of state laws in seeking to eradicate predatory mortgage lending, the OCC has chosen to preempt them. In so doing, the OCC has not offered a comprehensive and uniform regulation to replace these important state laws. Instead, the OCC has adopted a single, narrowly drafted provision which prohibits national banks and their operating subsidiaries from making a home secured consumer loan "based predominantly on. . . the foreclosure or liquidation value" of the home and "without regard to the borrower's ability to repay the loan. . . ." 12 CFR 34.3(b). Even this narrow prohibition is further constrained by the broad authority granted to banks to determine when a borrower has the "ability to repay." *Id.*

The OCC's second "consumer protection" effort—a simple restatement of the Federal Trade Commission's prohibition against unfair and deceptive practices—is already applicable to these institutions and imposes no additional duties on banks and their operating subsidiaries. See 12 CFR 34.3(c); 7.4008(c).[12] Indeed, the OCC could have chosen to more comprehensively address the unfair and deceptive practices while affording uniformity to national banks by drawing upon state models to remedy these serious problems.[13] Instead, no other regulatory provisions have been adopted to replace these important laws. OCC Advisory Letters which address predatory lending practices articulate no clear legal standards. See OCC Advisory Letters 2003-2 and 2003-3. More significantly, they afford no legal redress to consumers, and cannot fill the void created by these broadly preemptive rules. The OCC apparently justifies this action by its conclusion that banks and their operating subsidiaries are not significantly involved in predatory lending.[14] However, this conclusion has been significantly called into question by the Center for Responsible Lending's analysis of OCC's research,[15] by comments received by

[11] *See, e.g.* OCC Advisory Letter 2003-2, *Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices* (February 21, 2003); and OCC Advisory Letter 2003-3, *Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans* (February 21, 2003).
[12] Moreover, OCC apparently regards even the FTC Act prohibition as applicable only to a bank's lending activities and not more broadly to deposit-taking and other bank activities. Compare 12 CFR 34.3(c) and 7.4008(c) with 7.4007 and 7.4009.
[13] If, as OCC suggests, it does not have authority to issue regulations identifying bank practices it regards as unfair and deceptive, it could easily have included the broad category of state unfair deceptive acts and practices laws in its list of state laws not ordinarily preempted. *See* 69 Fed. Reg. 1904 at 1911.
[14] *See,* OCC Working Paper, Economic Issues In Predatory Lending, July 30, 2003.
[15] *See,* Center for Responsible Lending, Comments on the OCC Working Paper, (September 2003).

the OCC and by the prevalence of predatory mortgage lending litigation against large national banks and their affiliates.[16]

The Overbroad Preemption of All State Consumer Protection Laws Is An Unwarranted Intrusion into the Exercise of Legitimate State Powers, An Encroachment Onto Express Judicial Powers of Visitation and Injurious to the Public Interest

AARP is concerned that the OCC's new rules are not limited to preemption of state predatory mortgage lending laws, but have implications that are far more extensive. The OCC has broadly preempted "state laws that obstruct, impair, or condition" national banks' exercise of their deposit-taking, consumer lending and real estate lending powers. At the same time, the OCC has identified limited categories of state laws that are not "inconsistent with the real estate lending powers of national banks" and are not ordinarily preempted. Even these laws—governing such traditional areas of state authority as, contracts, torts, debt collection, real estate transfer—are preempted if their effect on the full exercise of the powers of national banks and their operating subsidiaries is more than "incidental."[17] *See* 12 CFR 34.4; 7.4007(b & c), 7.4008(d & e). Notably absent from the short list of normally non-preempted state laws are state unfair and deceptive acts and practices (UDAP) statutes and state common law claims for fraud and unconscionability. AARP submits that the OCC's broad preemption is not merely unauthorized, but that it ignores pressing problems identified by the states and thereby is detrimental to the public interest.

Laws to protect consumers have traditionally been the province of state government. State consumer protection laws that are generally applicable to all consumer transactions offer a range of protections to consumers in their everyday business dealings. These laws establish minimum codes of conduct, provide redress and cannot reasonably be found to "significantly interfere with the national bank's exercise of its powers."[18] Other state laws, such as laws licensing mortgage brokers and lenders, home improvement contractors, automobile dealers, and finance companies serve an important function in regulating local commerce and ensuring

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[16] *See e.g., Sandy and Michael Packer v. Bank One,* Case No: ___ (Case Number to be assigned.) (Court of Common Pleas, Fairfield County, Ohio). This case, against a national bank, challenges the bank's repeated refinancings of its own mortgage loan, with points and fees exceeding $12,000 on loans of $140,000, with interest rates over 10% when conforming rates were close to 7%, and unaffordable monthly payments that increased with refinancing; *Wells Fargo Home Mortgage v. Denise Brown et al. v. Peach & Pep Construction Co.,* Case No. 00-CH-481 (Cir. Ct. St. Clair County, Ill.). Case is against an operating subsidiary of Wells Fargo national bank; *Hopkins v. Anderson, et al.,* Case No: C2 03 612 (Court of Common Pleas, Muskingum County, Ohio). This case is against ABN AMRO Mortgage Group, a subsidiary of Standard National Bank; *Jefferson v. Citibank* as Trustee for Chase Manhattan Mortgage Corp, Case No. # 03-cv-4366 (D.C. Superior Court). Suit involves Citibank's role as trustee. National banks often derive significant profits from their role as trustees for securitization trusts that include significant numbers of predatory mortgage loans. For example, Bankers Trust Co., N.A., Chemical Bank and Norwest Bank, N.A. served as trustees in securitizations for loans made by the now defunct predatory mortgage lender, First Alliance Mortgage Co.

[17] Docket No. 03-16 at 21.

[18] *Barnett Bank v. Nelson.* 517 U.S. 25, 33 (1996).

fairness in consumer transactions. To the extent that these state licensed entities are doing business with national banks, these laws are also preempted under the OCC's broad rulemaking.[19] This action, which enables state licensees to ignore state legislative and regulatory requirements, extends the reach of the OCC into an area well beyond its enforcement capacity and expertise.

AARP is further concerned that the OCC's action not only limits the substantive protections in these state laws, but also effectively nullifies the ability of consumers to obtain access to and redress through the courts, by preempting both state and private rights of action. Moreover, OCC's belief that it cannot adopt a comprehensive regulation—analogous to state UDAP laws—defining and prohibiting specific practices as unfair and deceptive highlights the limbo into which injured consumers have been thrust by OCC's action.

The new rule also unjustifiably cuts off the visitorial powers granted to the judiciary under the National Bank Act.[20] Despite OCC assurances in its January 2003 proposed rulemaking that it was not encroaching upon the visitorial powers expressly reserved to the judiciary by the National Bank Act, the current action does just that.[21] Preempting state laws that provide state and individual rights of action undermines the judicial oversight over banks and operating subsidiaries that is afforded through those mechanisms. Here, the OCC would deny consumer protection enforcement, not only to those individuals and to the states, but also to the judiciary. Victims of misrepresentation, deception, fraud and unconscionable practices may be denied redress against the perpetrators of these offenses, if the perpetrators are national banks or their operating subsidiaries.

AARP, which has been representing homeowners victimized by predatory mortgage lending practices for 12 years, has long relied on state UDAP laws to obtain redress for victims of predatory mortgage lending. A recent case, involving a subsidiary of National City Bank, the initiator of the process that led to the new rule, highlights the important role of these laws in obtaining redress for consumers when federal law is not a sufficient deterrent, and the important role of the judiciary in visiting the behavior of national bank subsidiaries. AARP attorneys represented ten older homeowners in a predatory mortgage lending suit in federal court involving ten loans originated by the same mortgage lender and sold to assignees in the secondary market.[22] Altegra Credit Corporation, a subsidiary of National City Bank, purchased one of the loans. The loan was already in arrears at the time of its purchase, its income verification had been fraudulently produced by the lender, and its documentation failed to comply even with Altegra's own underwriting requirements. The lawsuit alleged—and ultimately proved—that the

[19] *See,* Preemption Determination, 66 Fed. Reg. 28593 (May 23, 2001) (preempting application of Michigan motor vehicle finance laws to "agent" of national bank).
[20] 12 U.S.C. §484(A).
[21] Docket No. 0302 at 24, Jan. 27, 2003.
22 Notably, assignees of the other loans included Wells Fargo, First Union and Household, all affiliates of national banks. National banks or subsidiaries involved in other AARP Foundation litigation include Bank One, Provident, and Citibank. *See Cooper v. First Government Mortgage and Investors Corp., et. al.,* (CA 1:00CV 00536, U.S. District Court for the District of Columbia).

loans were unconscionable under state UDAP law and were made without regard to the borrower's ability to repay in violation of HOEPA.

Altegra's conduct of the litigation was singular. Altegra demonstrated repeatedly that it had no understanding of HOEPA or its due diligence responsibilities as an assignee and that through its own conduct, Altegra aided and abetted the making of an unaffordable and fraudulent loan. Altegra settled on the eve of trial. The jury returned a verdict affirming the Truth in Lending Act and HOEPA violations. More importantly, in March 2003, the jury awarded $4.1million in punitive damages to six of the plaintiffs based on their finding that the loans in question were unconscionable under the state UDAP law.

Under the OCC's preemption rule, these homeowners, some of whom were facing foreclosure, would have been deprived of the ability to seek judicial redress. The rule preempts the direct state law claims brought by the *Cooper* plaintiffs without offering any alternate private right of action. Beyond this, the preemption action deprives the judiciary itself of the visitorial powers granted it by Congress and leaves regulation of a huge segment of the mortgage market to the limited resources of the OCC.

The breadth of preemption remains to be tested in litigation, but the harshest impact will likely be felt by those with the greatest need for state law protection—homeowners facing foreclosure. With this rule, the OCC likely deprived these homeowners of their ability to raise state law defenses to foreclosure when the mortgage is originated by a national bank or its state licensed, non-bank operating subsidiary. Unprecedented numbers of homeowners, who have in the past been able to rely on state protections in defending foreclosures, are likely to lose their homes as a result of OCC's action. Moreover, as a practical matter, the OCC does not have the resources to step in to stop individuals' foreclosures.

State consumer protection laws, and the consequent ability to seek redress, ensure bedrock principles of fairness in consumer transactions. AARP believes the OCC's rule undermines these fundamental consumer protections. In addition, the combination of the OCC's rules on preemption and visitorial authority wrest authority from states even to enforce those few laws that the OCC does not preempt, thus enabling national banks to avoid these laws as well.

Operating subsidiaries of national banks are subject to state consumer protection laws and visitorial powers

AARP is particularly concerned about the OCC's decision to extend the preemption of state laws to operating subsidiaries of national banks. While the national banking laws preempt some state laws as to national banks, grant the OCC some preemption authority as to national banks, and give the OCC primary visitorial power over national banks, these laws apply only to national banks. What these laws do *not* do is make operating subsidiaries synonymous with national banks. Nor do they grant the OCC authority to treat them as such. As a result, there is no authority in federal law that would: (1) allow the OCC exclusive visitorial powers over

operating subsidiaries; and (2) allow operating subsidiaries of national banks the same preemption of state laws as is available to national banks. AARP strongly opposes the OCC's expansion of its power over these creatures of state law.

Despite the OCC's assertions, operating subsidiaries are not departments of national banks but are separate, state-created legal entities. They are not "national banks" or "national bank associations" and the primary authority granted the OCC to examine "national banks" does not extend to them.[23] In fact, as the statute makes clear, the OCC's authority over affiliates such as operating subsidiaries is quite limited.[24]

National banks are well defined in federal law as instrumentalities of the federal government that are federally chartered and are, among other things, eligible to become members of the Federal Reserve System.[25] Section 371, which grants "national banks" authority to do real estate lending, does *not* extend that authority to operating subsidiaries and other affiliates of national banks.[26] The OCC's reliance on the Graham-Leach-Bliley Act (GLBA), 15 U.S.C.§41, as establishing its authority to regulate operating subsidiaries of national banks is misplaced.[27] As a result, states are completely free to license and examine operating subsidiaries.

The OCC has failed to address commenters' legitimate concerns that it has vastly overstepped its bounds in sweeping state chartered non-bank operating subsidiaries into its rules preempting state law and state visitorial authority. OCC's aggressive extension of its visitorial powers deflects attention from commenters' primary concern—the campaign by the national banks to insulate these banks and their state chartered non-bank operating subsidiaries from both state and judicial scrutiny.

Operating subsidiaries of national banks are state-chartered, non-bank corporations that exist under the laws of the state in which they are incorporated, exist only at the pleasure of that state, and are subject to dissolution by that state. In addition, these entities are entitled to do business in other states only if they comply with state licensing and other state regulatory requirements. They are guests of other states in which they do business. They are, as a result, subject to the laws of the states in which they are incorporated and in which they operate.

AARP is particularly concerned that the OCC's action preempts state laws as to national bank operating subsidiaries. In AARP's experience, these entities are much more likely than the national banks themselves to engage in abusive mortgage lending practices. AARP believes the activity of these entities must be subject to examination and regulation by the states and to state-created private rights of action to provide redress to their consumers.

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[23] *Compare* 12 U.S.C.§§221 & 221a with §§484 & 481.
[24] 12 U.S.C.§481.
[25] 12 U.S.C.§221.
[26] *Compare* 12 U.S.C.§§221 and 221a with 12 U.S.C. §484.
[27] *See, Minn. v. Fleet Mortgage Corp.*, 181 F.Supp.2d 995 (D.Minn. 2001) (operating subsidiary of national bank is not a national bank under GLBA and the OCC does not have exclusive jurisdiction over it).

Conclusion

AARP does not believe that the OCC has the authority to broadly preempt state laws that affect national banks. State predatory lending and UDAP laws play an important role in ensuring fairness in consumer transactions, through substantive protections and access to the courts. AARP believes that preemption of these state laws will expose older borrowers to intensified predatory behavior, equity stripping and foreclosures. Older borrowers will find it much more difficult to make comparisons when shopping for loans if different lenders are able to follow different rules in the states. Finally, AARP is concerned that, even if the OCC had the authority to adopt this broad based preemption, it does not now have the resources sufficient to substitute for state enforcement and private rights of action necessary to ensure fairness in the marketplace.

I appreciate this opportunity to testify on behalf of AARP on this important issue. We urge Congress to take steps to curb the OCC's overbroad exercise of power and to better protect consumers in the marketplace. I would be happy to answer any questions you may have.

AARP

THE AARP FOUNDATION
History and Role

The AARP Foundation was established in the District of Columbia in 1961 as a 501(c)(3) nonpartisan charitable corporation, contributions to which are tax deductible. The Foundation was originally named the Retirement Research and Welfare Association and was set up to engage in the study and discussion of issues affecting aging persons.

In 1983, the Retirement Research and Welfare Association changed its name to the AARP Foundation and shifted its emphasis to promoting projects and community service endeavors related to the social welfare, maintenance, and improvement of health and educational services for older persons. During the 1980s and early 1990s, the AARP Foundation received grants for various AARP projects and also awarded small grants to a variety of community service, educational, and social welfare groups.

On December 19, 1995, the President signed into law the Lobbying Disclosure Act of 1995 which prohibits 501(c)(4) organizations that lobby from receiving federal funds. Although the lobbying act only applies to new grants, AARP transferred all of its public and private grant programs (staff, funds, and administration) to the AARP Foundation. These transfers were approved by all of the federal funding agencies.

The AARP Foundation administers educational, employment and community service programs funded by both private and federal grants. Federal funding totaled an estimated $53 million in 2002. Major grant programs of the AARP Foundation include the AARP Senior Community Service Employment Program and the AARP Tax-Aide Program. The Foundation also includes the AARP Foundation Litigation group. The AARP Foundation's seven-member Board of Directors is appointed by the AARP Board of Directors and provides oversight and guidance to the AARP Foundation's management. The Director and Managing Director of the AARP Foundation supervise the Foundation's administrative, financial, and professional activities. Under a service provider agreement, AARP provides the AARP Foundation with support services and specialized skills needed to carry out some of the grant-funded programs.

AARP Foundation Managing Director's Office, September 24, 2003

AARP Statement of Federal Grants & Contracts Pursuant to Rule XI, Clause 2(g)

On December 19, 1995, the President signed into law the Lobbying Disclosure Act of 1995 which prohibited 501(c)(4) organizations that lobby from receiving federal funds. Although the lobbying act only applies to new grants, AARP transferred its current grant programs (staff, funds, and administration) to the AARP Foundation, a 501(c)(3) nonpartisan, charitable corporation established in the District of Columbia in 1961. These transfers, effective January 1, 1996, were approved by all of the federal funding agencies.

	2000 Audited	2001 Audited	2002 Audited
Revenues			
Department of Labor: AARP Senior Community Services Employment Program (SCSEP) (1)	$53,539,723	$52,147,002	$49,103,856
Internal Revenue Service: AARP Tax-Aide (2)	3,418,098	3,335,653	3,201,891
Housing and Urban Development: AARP Reverse Mortgage Education Project [3]	181,356	612,307	655,284
Health & Human Services:			
Special Programs for the Aging Title IV and Title II Discretionary Projects			306,163
AARP National Legal Training Project	138,898	212,758	
AARP Technical Support for Legal Hotlines	118,465	52,446	0
AARP Mental Health Coalition Building Project	24,771	85,261	0
AARP Senior Medicare Patrol Project	162,895	205,051	0
Alaska Senior Medicare Patrol Project Subgrant	16,000	0	0
Department of Justice:			
AARP Telemarketing Fraud Prevention and Education	67,495	372	163,831
Total Federal Grants	$57,667,701	$56,650,850	$53,431,025

Three Largest Programs:

(1) The AARP SCSEP is a work-training program authorized under the Older Americans Act of 1965. Eligible program applicants must be at least 55 years of age, physically able to work, and have income at or below 125% of the federal poverty level. In 2002, this program operated in approximately 94 sites in 31 states and Puerto Rico. For the grant-year ending June 30, 2002, the program served 18,000 individuals and had an unsubsidized placement rate of 54%.

2) The AARP Tax-Aide Program provides free tax counseling for low and middle-income individuals, with special attention to those 60 and over, through a network of approximately 9000 sites and approximately 31,000 volunteers. In 2002, this program helped more than 1.8 million taxpayers.

(3) The AARP Reverse Mortgage Education Project improves the quality and availability of consumer counseling and information and increases consumer awareness of reverse mortgage options and their alternatives.

Testimony of

THOMAS J. MILLER
Attorney General of Iowa

Before the
Subcommittee on Oversight and Investigations
House Committee on Financial Services

CONGRESSIONAL REVIEW OF OCC PREEMPTION

January 28, 2004

I wish to thank the Subcommittee for holding oversight hearings on this important issue, and for inviting the views of a state attorney general. In all 50 states, we are the public officers charged with protecting consumers, and ultimately are accountable through the electoral process to our citizens for our performance of that task. We have long been the front line force for this task. What we are discussing here today is whether a single federal agency should unilaterally decide that the facts should be otherwise. What we are discussing here today is not just about arcane, obscure banking regulations. These are fundamental issues of democracy, accountability, federalism, and the boundary between legislative prerogative and bureaucratic fiat.

THE PROPER BALANCES OF FEDERAL AND STATE STANDARDS, AND AUTHORITY TO ENFORCE THOSE STANDARDS ARE LEGISLATIVE DECISIONS, NOT BUREAUCRATIC ONES.

There is a certain amount of revisionism in the OCC's telling of the tale of its powers and those of the national banks it regulates. While the agency has labored mightily to argue that it is merely exercising long-existing powers, that is disingenuous. Public statements, such as Comptroller Hawke's aggressive and condescending remarks in a speech last September suggest a surprising hostility to the long-standing role of the states, and an agenda driven by the

competition with the states over whether banks will choose state or federal charters.[1] Such competition and hostility should lessen or eliminate a court's deference to the discretion of the OCC in its interpretations of its own powers and the preemptive effect of the law. Irrespective of how one feels about the direction the OCC is going in substance, no one else familiar with the law or regulatory history pretends that there has not been an effort in the past decade at the OCC to push the envelope as far as possible -- and farther than it ever has been. The question for this oversight committee is whether the agency has overshot its mark, particularly in three recent regulations: the 2001 OCC rule §7.4006, granting state-chartered operating subsidiaries the same preemption rights and visitorial immunity as the parent national banks;[2] and the two rules promulgated just this month on the gifts that come with a national bank charter. One grants sweeping preemption rights of state laws, jeopardizing consumer protection laws, to national banks and, purportedly to their operating subsidiaries, 69 Fed. Reg. 1904 (January 13, 2004), and the other protects them from enforcement of laws -- state or federal -- except by the OCC itself, 69 Fed. Reg. 1895 (January 13, 2004). State attorneys general submitted comments to both of the latter rules, copies of which are submitted along with my written testimony. I believe the committee will find them helpful both in presenting a balanced discussion of the law, as well as providing examples of the practical impact of the OCC's shifts as it has affected our consumer protection efforts.[3]

In laying an historical groundwork for its positions, the OCC cites the historical record of Civil War-era debates wherein Congress assumed the national bank system would supercede the

[1] Remarks by John D. Hawke, Jr., Comptroller of the Currency, Before Women in Housing and Finance, Washington, D.C., September 9, 2003, http://www.occ.treas.gov/ftp/release/2003-69a.pdf.

[2] 66 Fed. Reg. 34792 (July 2, 2001)

[3] Appendix A, Comments of the Attorneys General of 50 states, the Virgin Islands and the District of Columbia Office of Corporation Counsel, Docket No. 03-16, 12 C.F.R. Parts 7 and 34 (October 6, 2003); Appendix B, Comments of the Attorneys General of 45 states, Puerto Rico, the Virgin Islands and the District of Columbia Office of Corporation Counsel, Docket No. 03-02 (April 8, 2003)

state banking system, and result in "diminution of control by the states over banking in general."[4] But history, as it often does, had different plans. Throughout the nearly 150 years since the National Bank Act was enacted, Congress has consistently hewn to a modified vision, where state law has a significant role, except where Congress has made an affirmative decision to preempt, and where states have the authority to use the judicial system to enforce non-discriminatory laws of general applicability.[5] What most observers see in the recent OCC actions is an effort to take the NBA to a place where Congress has yet to specifically decide it should go – to uniform federal standards that virtually eliminate the traditional role of the states in enacting and enforcing consumer protection laws.

Moreover it is arrogating unto itself the authority to decide, to a great extent, what those uniform standards will be. Irrespective of whether a court grants it that right under an agency deference analysis, there is a serious public policy question as to whether "competing interests could be better balanced...by a national Congress whose interests are diverse and universal, or even by the people as they are represented in the state legislatures, than by a solitary institution whose focus is a single industry," as the Fifth Circuit has said, even as it accepted the OCC's position in *Wells Fargo v. James*, 321 F.3d 488, 494 (5th Cir. 2003). Finally, we should be mindful that those agency-created standards will have impacts farther than national banks themselves – farther even than the OCC's recent extension to operating subsidiaries: the impact of parity laws and the search by other lenders for that "level playing field" with the "most favored lender" could well lead to a significant erosion of state laws with virtually no legislative action at either federal or state level.[6] The ultimate question for this Committee is who decides

[4] 68 Fed. Reg. 6363, 6367 (February 7, 2003).

[5] Some of the case law is set forth in the appended Attorney General comments. A more detailed examination of the history of the National Bank Act, preemption and visitation will appear this spring in Arthur E. Wilmarth, Jr., The OCC's Preemption Proposals Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System, (23 Annual Review of Banking Law, *forthcoming* Spring, 2004).

[6] The Supreme Court's decision in *Marquette National Bank v. First of Omaha Serv. Corp,* 439 U.S. 299 (1978),
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the balancing questions necessarily involved in determining what level that playing field should be on? -- Congress and state legislators, or a single federal agency.

As Professor Arthur Wilmarth has explained, in the first half-century of the national banking system, national banks served a dual purpose – one public, one private. The public purpose was that of lending to the government through its role as primary purchaser of government bonds and issuing national currency.[7] The private purpose was that of all banks – taking deposits, making loans, serving shareholders. After the creation of the Federal Reserve System in 1913, the public function was transferred to the federal reserve, leaving the national banks, like the state banks to serve the private function. At the root of the recent OCC campaign there appears to be a belief that there is now a new public purpose to be served – to set uniform national standards in this era of a mobile society and technology that knows no geographic boundaries.[8] Irrespective of the merits of that question ultimately, the fundamental flaw with the OCC's recent efforts is that it is Congress which should make that decision, and Congress has not yet made it. When it considers it, as the Fifth Circuit noted, the balancing of competing interests may be done far more carefully, and with far greater nuance, than is being done by this single regulator. Undoubtedly the OCC is eager to move toward that goal faster; perhaps it is impatient with the pace at which policy decisions are made in a democratic republic.

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interpreting the National Bank Act, in effect, to authorize a phenomenon which could be called "sister-state preemption" – allowing the state law of a bank based in one state to preempt the state laws of its customers nation wide – led to efforts by non-national banks to get the same preemption benefits national banks had. Given that *Marquette* was only two years old at the time, it is not certain how many realized that Sections 521 - 523 of the Depository Institutions Deregulation and Monetary Control Act of 1980 [P.L.96-221, Title V, Part C], together with *Marquette,* would result to a large degree to the nationwide deregulation of credit cards, largely under rules established by the OCC.

[7] See, e.g. *Tiffany v. National Bank of the State of Missouri*, 85 U.S. 409, 413 (1874) ("National banks have been national favorites. There were established for the purpose, in part, of providing a currency for the whole country, and in part to create a market for the loans of the general government. It could not have been intended, therefore to expose them to the hazard of unfriendly legislation by the states, or to ruinous competition with state banks.) Emphasis added.

[8] See, e.g. 69 Fed. Reg. at 1907-1908 (OCC supplementary information to final preemption rule).

But the real question is, should that be left to bureaucratic fiat, or should it be a Congressional decision?[9] *See also* Jess Bravin and Paul Beckett, "Dependent on Lenders' Fees, the OCC Takes Banks' Side Against Local Laws," Wall Street Journal (January 28, 2002) ("The OCC's solicitousness toward businesses it oversees stems in part from its need to compete for their loyalty. In an uncommon arrangement, banks can choose either a state or federal regulator, and the selection has financial consequences: The OCC and state banking departments subsist entirely on fees paid by the institutions they regulate.")

For over thirty years, Congress has made incremental changes, at each stage weighing the proper balance of national standards versus state standards, consumer interests versus banker and lender interests in a wide variety of contexts. In making these changes, it very clearly has signaled that it is not yet ready to go where the impatient OCC wants to go. In the various enactments of the Consumer Credit Protection Act, Congress generally set the federal standard as the floor, only preempting directly inconsistent state laws, and permitting states to provide greater protections to consumers.[10] We have yet to find from the record or institutional memory signs of Congressional intent that national banks would be treated differently. Indeed, when Congress was considering the predatory lending and "reverse redlining" problems that ultimately led to HOEPA, which also held the federal standard to be a floor,[11] the Fleet corporate family

[9] These OCC pronouncements fundamentally alter the historical balance of state and federal authority – reversing presumptions as to the applicability of state law. Leaving this fundamental change in the hands of a regulatory agency – this one in particular, given its funding mechanism, can foster public cynicism that special interests, not democracy, drive decision-making -- views not necessarily limited to those who oppose the ultimate goals. *See, e.g.* Amy Bizar, Fred H. Miller, and Alvin C. Harrell, "Introduction to the 2000 Annual Survey of Consumer Financial Services Law," 55 Bus. Lawyer 1255, 1259 (May, 2000) (discussing reasons for absence of discussion about revisiting the Uniform Consumer Credit Code as an alternative to federalizing the law, "unlike federal agencies that may view preemption of state laws as an integral part of an empire-building strategy to expand their clout and jurisdiction, there is no centralized regulatory constituency at the state level that inherently benefits from legal reform."). (Emphasis added).

[10] 15 U.S.C. § 1610; Reg. Z, 12 C.F.R. § 226.18, Official Staff Commentary § 226.28(a)-2,3 (Truth in Lending); 15 U.S.C. § 1691d(f) (Equal Credit Opportunity Act); 15 U.S.C. § 1693q (Electronic Funds Transfer Act); 15 U.S.C. § 1692n (Fair Debt Collection Practices Act); 15 U.S.C. § 1677 (Restrictions on Garnishment).

[11] "The Conferees intend to allow states to enact more protective provisions than those in this legislation." 1994 U.S.C.C.A.N. 1987, 1992.

was in the thick of publicity in Boston and Atlanta, and a representative was called to testify before the Senate Banking Committee on the topic.[12] Though this federal floor preemption model had been in place for nearly 30 years, to my knowledge, it has only been in recent years that the OCC has taken the position that the National Bank Act trumps those federal preemption standards to preempt state laws on those issues.[13]

By 1994, the OCC's newly aggressive preemption stance had become apparent, and Congress used the vehicle of Riegle-Neal to warn the OCC that it was being "inappropriately aggressive" in preemption, citing specific examples of a type of law that now clearly would be preempted under OCC rules enacted in the past three years.[14] In 1999, Congress enacted the Gramm-Leach-Bliley Act – major legislation that significantly changed the business of banking. When Congress included important privacy protections as part of the GLBA, it continued the tradition of preempting only those state laws that directly conflict with the federal law, and expressly permitted states to enact laws that afford greater protection than the federal law.[15]

In short, when it comes to the full panoply of consumer protection, Congress has not yet decided that a uniform federal standard is appropriate as far across the board as the OCC's recent rules would take it. (Indeed, we know that Congress is still considering some of the very issues that these rules would take into the OCC's hands. It was less than three months ago that you and your colleagues on the Subcommittee on Housing and Community Opportunity and the

[12] *Problems in Community Development Banking, Mortgage Lending Discrimination, Reverse Redlining, and Home Equity Lending,* Hearings Before the Senate Comm. On Banking, Housing and Urban Affairs, 103rd Congress, 1st Sess. (February 17, 1993).

[13] It did so successfully in *Bank One, Utah v. Guttau*, 190 F.3d 844 (8th Cir. 1999) (competing EFTA preemption standard as to various ATM issues; note dissent); *Bank of America v. City and County of San Francisco*, 309 F.3d 552, 564 (9th Cir. 2002) (same); *American Bankers Association v. Lockyer*, 239 F. Supp. 2d 1000 (E.D.Ca. 2002), appeal pending (competing TILA standard as to credit card disclosures.)

[14] H.R. No. 103-651, *reprinted* in 1994 U.S.C.C.A.N. 2068, 2074-2075. See page 10, below.

[15] 15 U.S.C. § 6807.

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Subcommittee on Financial Institutions and Consumer Credit invited me to testify as you consider some of the very issues that the OCC seeks to resolve itself as to national banks and their operating subsidiaries.[16] I had rather thought that it was your decision, but apparently there is another view.) In trying to preempt not only the states, but arguably Congress, as well, the OCC has bypassed the important, open discussion and review that elected representatives of Congress -- with its vigilance toward concerns of federalism, and its representation of the broad and diverse interests that are all of America – would bring to the debate.

Looking carefully at the implications of OCC actions, a further shadow falls. Not only has the agency decided that the federal standards should be uniform, but, to a large extent, that it will be the body to decide what those standards are. If past is prologue, the evidence is that there will not be a careful balance. The agency has already expanded preemption by changing definitions from existing law, including its past positions.[17] That the federal standards adopted by the

[16] Joint hearing on "Protecting Homeowners: Preventing Abusive Lending While Preserving Access to Credit," November 5, 2003.

[17] We have already seen one cycle of how the *agency's* federalization of law expanded the NBA's preemptive sweep. The usury preemption of Section 85 is a well-accepted express preemption in the National Bank Act. But it preempted state laws which might have discriminated against national banks by permitting the latter to be on a par with the "most favored lender" under state law. In taking advantage of Section 85, a national bank had to "borrow" the state law applicable to the most favored lender in that state. *See, e.g. Attorney General v. Equitable Trust Co.*, 450 A.2d 1273 (Md. 1982).(The bank could take advantage of an "alternative federal rate," but that rate is pegged to the federal discount rate, hence often lower than the "most favored lender" rate borrowed from state law.) Traditional usury analysis, adopted by Congress in its Truth in Lending definition of "finance charge" is that charges for actual, unanticipated late charges are not interest. The OCC historically had agreed with that position. OCC Letter, Saxon, J (June 25, 1964). When the *post-Marquette* credit card exportation industry arose, the OCC then took the position that if the bank's base state broadly defined "interest" to include late fees (which the exportation states did by statute), the OCC opined that a late fee could be interest if the relevant state law so defined it. OCC Letter No. 452, R. Serino, Deputy Chief Counsel (Aug.11, 1988), *reprinted* [1988-89 Transfer Binder] Fed. Banking. L. Rep. (CCH) ¶ 85,676.

Then, among the cases challenging late fee exportation was one which raised a constitutional question as to whether federal law could, in effect, delegate preemption authority to a state, transforming that state's law into a uniform national standard. The trial court held that it would be an unconstitutional delegation of authority. *Irwin v. Citibank (South Dakota)*, No. 9112-2557 (Penn. Ct. Com. Pleas, *opinion filed Dec. 9, 1993)*. The OCC's position then switched from state law-controlled definition to a federal definition of interest, and defined it much more broadly than traditional law did. OCC Letter No 676, J. Williams, Chief Counsel (Feb. 17, 1995), *reprinted* [1994-95 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,618. Because the late fee exportation challenges had made their way up through the appellate system, the position in that letter was promptly published as a proposed interpretive rule, 60 Fed. Reg. 11925 (Mar 3, 1995), and finalized shortly before the oral argument in *Smiley v. Citibank (South Dakota)*, 517 U.S. 735, 135 L.Ed 2d 25 (1996). Though the Court deferred to the OCC's

OCC could be viewed as something less than a balancing of competing interests is further evident in the curious Alice in Wonderland logic of its definition of interest. It's a broad definition when exporting a rate, § 7.4001(a), but it is not so broad if it would be inconvenient for the bank under its home state law. §7.4001(c). Under the new rules, it reverses the presumption of preemption, and has air-brushed out of long-standing law the limiting qualifications as to the preemptive scope of the NBA. The presumption is that state law applies except where expressly preempted, or there is a prohibition or significant impairment. (See Appx A, Attorney General Comments, Docket 03-16, pp. 3-4). Under the OCC's new rules, the presumption is reversed, and the limiting qualification is removed. "Except where made applicable by federal law, state laws that obstruct, impair, or condition a national bank's ability to fully exercise" its authority are preempted. §§7.4007(b), 7.4008(d), 7.4009(b), and 34.4(a).

This change creates some awkwardness for the OCC, for some state laws that would almost assuredly be preempted under this new standard, if coming to the OCC on a clean state, have already been addressed by the courts or Congress. A state anti-redlining statute would "condition" a bank's ability to fully exercise its authority, but that has already been held not preempted by the NBA.[18] State fair debt collection practices statutes, some of which apply to creditors collecting their own debts, would "condition" a bank's full authority, but debt collection, too, has already been addressed.[19] But even as to this, there is some disquiet about that provision in the new preemption rule. The OCC includes on the list of laws generally not

interpretation, the switch in the OCC's position from reference to state law to a newly federalized definition is an early step in what continues to be the OCC's effort to federalize banking law by agency rule, rather than by Congressional debate by officials accountable to voters. Of import to today's consideration is that fact that the broad definition of interest adopted by the OCC to facilitate broader preemption of state laws is that it was contrary to the federal definition which had already existed for nearly 30 years, in Truth in Lending, which also excluded late fees from the definition of interest.

[18] *National State Bank, Elizabeth, N.J. v. Long*, 630 F.2d 981 (1980).

[19] *First National Bank v. Commonwealth of Kentucky*, 76 US (9 Wall) 353, 362; 19 L.Ed 701, 703 (1870). The federal act, which applies only to third-party collectors, specifies that it is a floor, and that states can enact more protective state laws. See note 10, above.

preempted "rights to collect debts," rather than "debt collection." §7.4009(2)(iv); §34.4(b)(5). Given its newly-minted characterization of state laws not preempted as ones relating to "infrastructure," one wonders if the intent is to permit the OCC to distinguish between state laws which permit collection and execution ("infrastructure"), and state laws which provide protections to consumers in the process, which the OCC or a bank might argue imposes "conditions" on the banks' rights.

Where it is Congress that has spoken against "inappropriately aggressive" preemption, the OCC does not appear to have whole-heartedly adopted the message. One of the specific preemption decisions Congress expressed concern about in 1994 was the agency's preemption of New Jersey's basic banking (lifeline account) law. The OCC withdrew that decision, but a look its 2001 rule § 7.4002 and new § 7.4007 leaves little question but that the OCC has not made that the general rule.[20] Similarly, Congress has specifically expressed its support for state consumer protection and fair lending laws, but it appears that the OCC finds it difficult to find a meaningful state consumer protection law that qualifies to remain in place, despite this Congressional concern. Indeed, given the preemption of the Georgia Fair Lending Act, I fear for the fate of North Carolina's highly effective anti-predatory lending act. My colleague Roy Cooper, the Attorney General of North Carolina, will be testifying shortly on the Senate side on this issue, and will, I am sure, speak more to this issue.

THE OCC'S RULES ENCROACH ON TRADITIONAL STATE CONSUMER PROTECTION FUNCTIONS

All three of the recent rules are not mere codifications of existing law, as the OCC would have it; they fundamentally change the rules in many respects. Prior to the 2001 operating

[20] Under § 7.4002, it is difficult to conceive of deposit account service charge that couldn't be justified under the bank's "business plan and marketing strategy." Section 7.4007(b) preempts state law "limitations" on checking accounts. The 1994 message from Congress, however, was that state laws on deposit accounts were by no means assumed to be so easily swept aside. 1994 U.S.C.C.A.N. at 2074 - 2075.

subsidiary rule, operating subsidiaries were created by and under state law, licensed by state regulators, routinely examined by those state regulators for compliance with state laws, and those state regulators enforced state law as to those operating subsidiaries. Those operating subsidiaries were sued by private parties for violation of state laws, including state regulatory and consumer protection laws. While the OCC insists that national banks are not a significant source of predatory mortgage lending problems, the extension of preemption to operating subsidiaries raises the ante. Some non-bank affiliates of national banks have been implicated.[21] One must also wonder if the agency's recent efforts to immunize national banks from all oversight save its own, and extended preemption, may remove a check on the banks themselves. The Better Business Bureau in Bank of America's home base recently noted that bank complaints jumped three fold, led by complaints about B of A. "Andrew Shain, "Customer beefs with B of A jump: Banks lead in Better Business Bureau complaints in '03," Charlotte Observer, (January 7, 2004). Indeed, the very effort to use broad preemption and immunity from state oversight – and in some cases even private enforcement of consumer laws – may well attract to the charter some entities who would abuse that. Combined with the preemption standards, and eliminating state enforcement of any laws – even non-preempted consumer protection laws, the OCC has arrogated unto itself complete discretion to determine the substance of applicable consumer protection laws. It can do so by preemption determinations, or by controlling enforcement of either state or federal law.

The new preemption rule does not mention "consumer protection laws" either in its list of what's preempted, or what's not preempted. That apparently means the OCC has taken it upon itself to rule upon the application of such laws on a case by case basis. §§ 7.4009(2)(viii); 34(b)(9). But, despite express Congressional intent when enacting Riegle-Neal that state consumer protection and fair lending laws remain viable as to national banks, it is difficult to

[21] Others at this hearing may address that subject. Comments submitted to the OCC listed some such cases. See, e.g. Comments of the National Consumer Law Center, Consumer Federation of America, National Association of Consumer Advocates, U.S. PIRG, Docket No. 03-16 (October 6, 2003)

envision ones that would stand under the rules as promulgated. Where will Iowa's right to cure notice requirement fall? Where will state anti-deficiency laws fall? Where will state garnishment protections greater than federal law fall? Indeed, where will state laws mandating judicial foreclosure fall? Are these non-preempted "infrastructure" laws, or are these laws preempted because they "obstruct, impair or condition" a bank's lending power? The OCC's wholesale preemption of Georgia's Fair Lending law does not give me confidence that the OCC will wield this authority with a scalpel rather than an ax.

UDAP laws are a type of consumer protection in which state and federal laws have co-existed: they have not been considered preempted, and, as laws of general applicability, applied non-discriminatorily, such laws have been applied to national banks.[22] But now the combination of OCC rules, and other recent OCC pronouncements leaves serious questions.

Until 2000, the OCC viewed its exam and enforcement authority as primarily as safety and soundness function.[23] The agency itself admits that it was not until 2000 that it found a consumer protection function, when it decided that it had authority to enforce the Federal Trade Commission's unfair and deceptive acts and practices statute, Section 5 of the Federal Trade Commission Act. (15 USC § 45). OCC personnel themselves posed the question, "why it took the federal banking agencies more than twenty-five years to reach consensus on their authority to enforce the FTC Act," and recognized that "[e]ven with the benefit of hindsight, the answer is not easy."[24] The answer the OCC postulates is that (to paraphrase), perhaps because national banks didn't engage in such behavior until recently,[25] though other explanations have also been offered,

[22] For some cases in which states enforced state consumer protection laws against national banks, see Appx. A, page 8, note 31.

[23] It has authority to examine for and enforce federal credit laws such as TIL, 15 U.S.C. §1607 and the ECOA, 15 U.S.C. §1691c.

[24] Julie L. Williams and Michael S. Bylsma, "On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks," 58 Bus. Lawyer 1243, 1244 (May, 2003).

[25] *Id.* ("Perhaps it is because the concerns that have been raised about aggressive and misleading marketing *by banks*

again, by people who may not necessarily oppose the ultimate direction the OCC is going. The former general counsel of Citigroup's US credit card practices has noted that the OCC ignored the "poster child of abusive consumer practices" in the credit card industry for 10 years – until a state official took action. It was that "fiasco" that was a "turning point for the OCC," causing it to find its consumer protection authority under the FTC Act.[26] The development has to be viewed in the context of the OCC's new aggressive interpretation of its "exclusive" visitorial authority, by which it seeks to deprive state attorneys general of the authority to enforce even non-preempted state laws of general applicability against national banks. As one industry lawyer explained, the OCC recognized that "it couldn't replace something with nothing."[27]

Where does this development leave consumers – and national banks and their operating subsidiaries? In its 2002 Advisory letter, the agency explained that it has authority to enforce state UDAP laws against national banks' operating subsidiaries. AL 2002-3, note 2. However, the OCC has now apparently federalized UDAP law, at least in part. The new preemption rules adopt a prohibition against unfair and deceptive practices, which the agency explains makes "all national banks and their operating subsidiaries...subject to uniform, consistent, and predictable rules of fair conduct wherever they do business throughout the United States." (OCC Preemption Final Rule, Question and Answers, p. 5). However, the rule was adopted only for loans. §§7.4008(c); 34.3(c). Where does that leave a consumer with respect to a national bank's unfair or deceptive non-lending practices? And if only the OCC has authority to decide what an "unfair or deceptive practice" is and when to take enforcement action, will its primary focus be protection of consumers and principled application of a UDAP law – or will it be concerned again primarily

are relatively recent developments." Emphasis in original) But, as has been noted, national banks have been the subject of both state and private actions.

[26] Letter to the Editor, Duncan A. MacDonald, American Banker, November 21, 2003.See also note 9, above.

[27] Remarks before the Practicing Law Institute, Consumer Financial Services Litigation, San Francisco, May , 2002.

with national uniformity, and the safety and soundness of its banks? And what is the status of FTC rules promulgated under section 5 that do not apply to banks?[28] The OCC has said it doesn't have rule-making authority, does that leave a double standard federal UDAP law? But more importantly, if all state UDAP laws are now effectively preempted, and replaced by a uniform federal standard, is that a decision that Congress, or a federal agency should make?

THE "EXCLUSIVE" VISITORIAL AUTHORITY IS BEYOND THE SCOPE OF EXISTING LAW AND WILL CONTINUE THE PATTERN OF AGENCY PREEMPTION AND AGENCY DEFINITION OF WHAT THE "FEDERAL" CONSUMER PROTECTION STANDARD WILL BE.

The pronounced shift in federal - state relations as to national banks is perhaps no more evident than in the new-found conceit that the visitation rule precludes states from enforcing even non-preempted laws of general applicability in courts. Combined with the extension of the rights of a parent bank to operating subsidiary, this is a profound change from what has been the case historically. As little as six years ago, it was state Attorneys General, under their respective state UDAP statutes, which sat down with a national bank financing highly questionable door-to-door sales of satellite dishes, water treatment systems, and home improvements.[29] It was nothing new or unusual - it was routine. Subsequently, two southwestern states had similar problems with door-to-door sales of air conditioning systems (with the added gloss of potential state civil rights laws, as Hispanics were allegedly targeted), and, incidentally, involving one of the same national

[28] The new rules say that, as to loans, the FTC act and "regulations promulgated thereunder" apply. Does that mean that the OCC is going to apply all the relevant FTC rules to banks? One of particular concern to states is the anti-holder rule, which is very important to consumers in protecting them from unscrupulous sellers, such as door-to-door home improvement sellers and some car dealers. This rule requires that the financing contracts arranged by such sellers contain a clause that says the holder of the contract is liable for claims and defenses the consumer has against the seller. Though the FTC rule applies to "sellers," not lenders, state UDAP laws have been held to make accountable lenders who try to deprive consumers of their rights under this rule – even national banks. *See Brown v. LaSalle Northwest National Bank*, 820 F. Supp. 1078 (N.D. Ill. 1993).

[29] These same practices also exposed some weaknesses in the TIL rules for open-end disclosures, which led several states to suggest reform to the Federal Reserve Board. National banks were involved in the financing of these sales, using the sellers to sell the financing, along with the goods and services.

banks. But the OCC encouraged banks to notify the agency if contacted by a state official, even issuing an unprecedented formal call to do so. (OCC Advisory Letter 2002-9, 11/25/02). The OCC inserted itself into the situation, and obtained a settlement with the bank. While it touts this as a mark that consumers will be adequately protected, (69 Fed. Reg., at 1900, note 41), the terms of that settlement may not give comfort to all that the decades of experience in the state attorneys general offices of enforcing consumer protection laws can easily be replaced by the OCC's newly minted experience – as of now, of only three years standing. The comment letter that all state Attorneys General submitted to the OCC (Appendix A) details similar tales of OCC intrusion into non-discriminatory state enforcement of non-preempted state laws of general applicability.

Other questions have yet to be answered, including the adequacy of one agency's resources, compared to that of 50 state Attorneys General. (This question becomes even more critical when one considers that there may be an impact on private rights of action, as well. See below). While the OCC policy makers in Washington are certain their resources are adequate to the task,[30] my staff has seen some front-line OCC faces pale at the notion that all complaints about all national banks from all over the country are theirs, and theirs alone to handle. (And rest assured, credit card complaints alone can keep them very busy for a very long time.)

Finally, one impact that has not received much attention is the way that these rules not only remove state laws and state enforcement to a greater extent than in the past as to national banks and their operating subsidies, but they also may, by the back door, deprive consumers of their right to protect themselves under state or federal law. If, as discussed above, the import of the OCC's action is eventually determined to mean that national banks are subject only to federal UDAP law, not state UDAP law, then consumers may have no private right of action, for there is no private right for consumers under Section 5 of the FTC Act. If the OCC's position stands, then

[30] And, if the marketing of the charter increases the OCC's market share enough, see note 9, their coffers may indeed overflow.

no state AG can protect consumers against a national bank or op sub's unfair or deceptive practice, nor, arguably, can consumers themselves.[31] It is all up to the OCC. Enforcement will not only be a matter of resources, but of will. Enforcement – and, to a large extent, interpretation – of the UDAP law nationwide will be entirely at the discretion of this agency. Even as to state UDAP laws, this new found UDAP authority may, by federal bureaucratic fiat, move banks and operating subs into an enforcement and application vacuum without action by either Congress or the state legislatures.

CONCLUSION

As I mentioned at the beginning, all the attorneys general signed onto the preemption comments, demonstrating that this is not a partisan issue, nor is it one which depends upon one's political philosophy about the proper role of government in regulating business. It is a basic question of federalism, and a basic question of whether fundamental, critical decisions about where the proper balance of federalism lies are made by elected, accountable legislators, or by bureaucratic fiat. Thank you again for this opportunity.

[31] Indeed, the Rhode Island UDAP statute exempts "actions or transactions permitted under laws administered by the department of business regulation or other regulatory body or officer acting under statutory authority of this state or the United States." The OCC filed an amicus in a private UDAP case, citing its new found UDAP authority, and the court held the national bank was protected from the private consumer's UDAP enforcement as subject to an exemption "as a result of the OCC's authority to bring enforcement actions against national banks for violations of laws or regulations...." *Roberts v. Fleet Bank (R.I.)*, 342 F.3d 260, 269-270 (3rd Cir. 2003).

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APPENDIX A

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October 6, 2003

Via Facsimile: (202) 874-4448

Office of the Comptroller of the Currency
250 E Street, S.W., Public Information Room, Mailstop 1-5
Washington, DC 20219

Re: Docket No. 03-16, 12 CFR Parts 7 and 34.

Dear Sir or Madam:

We, the undersigned Attorneys General of 50 States and the Virgin Islands and the District of Columbia Office of Corporation Counsel, submit the following Comments on the rules proposed by the Office of the Comptroller of the Currency in Docket No. 03-16. As the chief law enforcement officials of our respective jurisdictions, we strongly oppose these preemption rules and urge the OCC to defer further action on them.

The OCC's current proposal, coupled with other recent OCC pronouncements on preemption, represents a radical restructuring of federal-state relationships in the area of banking. In recent years, the OCC has embarked on an aggressive campaign to declare that state laws and enforcement efforts are preempted if they have any impact on a national bank's activities. The OCC has zealously pushed its preemption agenda into areas where the States have exercised enforcement and regulatory authority without controversy for years.

The OCC's preemption analysis is one-sided and self-serving. The OCC has paid little deference to well-established history and precedent that has allowed the States and the OCC to coexist in a dual regulatory role for over 130 years. That precedent has upheld this nation's policy that national banks are subject to state laws unless the state laws significantly impair the national bank's powers created under federal law. The OCC is destroying that careful balance by finding "significant interference" or "undue burden" whenever state law has <u>any</u> effect on a national bank.

The States acknowledge that the National Bank Act preempts some state laws, such as regulation of credit card interest rates charged by out-of-state national banks.[1] Particularly in the area of consumer protection, however, there are state laws that affect virtually all commercial entities doing business with the public, including banking institutions. These laws do not impose significant burdens on national bank activities and are applied evenhandedly throughout the marketplace. As a general rule, state consumer protection laws prohibit businesses from engaging in unfair or deceptive practices. These laws are consistent with Section 5 of the Federal Trade Commission Act, and the States traditionally have enforced them in a wide range of financial activities involving consumers. A national bank's compliance with these laws should be expected and welcomed by the OCC, not regarded as a "significant impairment" of the bank's federal rights. It would be unprecedented and unfair to grant national banks (including, in the OCC's view, affiliated nonbank institutions) total immunity from all state consumer protection regulation and enforcement.

In the area of predatory mortgage lending, the OCC's actions are particularly disappointing. The States have taken a leadership role in devising legislation to restrict abusive practices in home equity lending. These state laws were carefully crafted to avoid preemption issues, to create safe harbors for mortgage lenders, and to add consumer protections to high cost subprime loans. In the States' experience, these laws have worked. Instead of commending the States' efforts, the OCC has gone to great lengths to attack them and to declare that they are inapplicable to national banks and their operating subsidiaries. In their place, the OCC has recommended minimal protections that fail to address many of the worst predatory lending abuses.

The States would prefer to cooperate and partner with the OCC, especially when enforcement resources are limited. The States and the OCC share similar goals of protecting the public and providing for a fair credit marketplace. But instead of seeking cooperation and joint enforcement, the OCC is insisting on an exclusive regulatory regime that would eliminate the role of the States, particularly with respect to such important consumer protection issues as predatory mortgage lending and telemarketing abuses. There is much work to be done by all regulatory and enforcement agencies on real and pressing problems. The States submit that this is not the time to devote energies to turf battles and empire building.

A. National Banks Historically Have Been Subject to State Laws and a Dual System of Enforcement.

The OCC's recent campaign to obtain exclusive enforcement authority over its constituent national banks, and to shield the banks from virtually all state laws, ignores a longstanding tradition of federal and state enforcement. Under this dual system, federal authorities have overseen the business activities of national banks to ensure the "safety and soundness" of banking institutions. The States, for their part, have enforced state laws of general application against all persons and businesses within their borders, including national banks. This complementary system of state and federal enforcement has worked well, both to maintain safe and sound banking practices, and to protect the consuming public from deleterious business practices. The dual system has roots not only in actual enforcement experience, but also in U.S. Supreme Court and other judicial precedents as

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[1] Marquette National Bank v. First of Omaha Service Corp., 439 U.S. 299 (1978).

well as Congressional pronouncements recognizing the vital role of the States in monitoring business activities within their borders.

1. Under Supreme Court Precedent, National Banks Are Subject to State Laws that Do Not Conflict With, or Substantially Impair, Bank Rights under Federal Law.

The National Bank Act ("NBA"), on which the OCC heavily relies to augment its powers, is a Civil War-era statute that was intended to finance the war and restore control of the monetary system to the federal government.[2] Contrary to the OCC's current assertions, the NBA was not intended to divest all state authority over national banks. Indeed, from its earliest decisions involving the NBA, the U.S. Supreme Court has recognized and upheld the applicability of state laws to national banks. In 1870, the Supreme Court rejected a preemption challenge to a state's collection of a bank shares tax, declaring that national banks "are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional."[3] In McClellan v. Chipman,[4] the Court rejected a bank's "assertion that national banks in virtue of the [NBA] are entirely removed, as to all their contracts, from any and every control by the state law," holding instead that state laws govern the business transactions of national banks except in areas where Congress expressly preempts state law or state law would impair the banks' efficiency in carrying out their duties imposed by federal law. Other Supreme Court decisions affirm the principle that national banks remain subject to many state laws.[5]

In general, the Supreme Court has upheld state laws that 1) did not expressly conflict with the statutory powers of national banks; 2) did not discriminate against national banks; or 3) did not impose undue burdens on the performance of bank functions mandated or permitted under national banking laws. Where the Court has found preemption, it usually has been in instances where the state law either prohibited or significantly impaired an express statutory power of a national bank.

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[2] Act June 3, 1864, ch. 106, 13 Stat. 99.

[3] National Bank v. Commonwealth, 76 U.S. (9 Wall.) 353, 361-62 (1870).

[4] 164 U.S. 347, 359 (1896).

[5] See, e.g., Davis v. Elmira Savings Bank, 161 U.S. 245, 290 (1896) ("Nothing, of course, in this opinion is intended to deny the operation of general and undiscriminating state laws on the contracts of national banks, so long as such laws do not conflict with the letter or the general objects and purpose of Congressional legislation."); First National Bank in St. Louis v. Missouri, 263 U.S. 640, 656 (1924) (National banks "are subject to the laws of a State in respect of their affairs unless such laws interfere with the purposes of their creation, tend to impair or destroy their efficiency as federal agencies or conflict with the paramount law of the United States."); Anderson National Bank v. Luckett, 321 U.S. 233, 244-52 (1944) ("National banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions," holding that a state statute administering abandoned deposit accounts did not "unlawful[ly] encroac[h] on the rights and privileges of national banks."); Franklin National Bank v. New York, 347 U.S. 373, 378 n.7 (1954) ("National banks may be subject to some state laws in the normal course of business if there is no conflict with federal law."). More recently, in the 1997 case, Atherton v. FDIC, 519 U.S. 213, 222-23, the Supreme Court reaffirmed the principle that "federally chartered banks are subject to state law," based on its earlier decisions.

The Supreme Court's 1996 decision in Barnett Bank of Marion County, N.A. v. Nelson[6] is consistent with these principles. In Barnett, the Court struck down a Florida law restricting the sale of insurance by national banks because a federal statute granted national banks the right to sell insurance in towns of 5,000 or fewer. The Court stated that preemption would be found if there was a direct conflict with express federal statutory authority because "normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted."[7] However, the Court went on to stress that the preemption test was not intended "to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank's exercise of its powers."[8]

Therefore, the test to determine whether a state law is preempted when applied to a national bank focuses on whether there is a "significant impairment" of a bank's express rights under federal law or a "significant interference" with the legitimate functions of a bank. This test reflects the traditional standard for conflict preemption in that only those state laws significantly interfering with a bank's exercise of its powers are preempted.

Lower court decisions also have recognized and affirmed the general applicability of state laws to national banks. For example, in Video Trax, Inc. v. NationsBank, N.A.,[9] the U.S. District Court for the Southern District Court of Florida observed: "Banking is not an area in which Congress has evidenced an intent to occupy the entire field to the exclusion of the states, and thus, state legislatures may legislate in all areas not expressly or impliedly preempted by federal legislation."

The OCC's current approach to conflict preemption flies in the face of these judicial precedents; it is so sweeping that, in reality, the OCC is establishing a regime of field preemption. The OCC presupposes that any state law that can arguably "impair the efficiency" of national bank lending operations compels a finding of preemption. Under this theory, most state consumer protection laws would be preempted, since such laws are unlikely to provide any protection without having some incidental impact on a bank's "efficiency." The OCC should not, by expansively interpreting the terms "impair significantly" and "significant interference," undertake to overturn over 130 years of precedent establishing that national banks are not entitled to immunity from all state laws and regulation.

2. Congressional Intent Supports the Applicability of State Law to National Banks and the Presumption against Preemption.

In 1994, Congress enacted the Riegle-Neal Interstate Banking and Branching Efficiency Act to permit national banks to operate interstate branches to better serve consumers. In enacting the legislation, Congress made a clear pronouncement of its intent that state law would continue to apply to the interstate operations of national banks, particularly in the area of consumer

[6] 517 U.S. 25 (1996).
[7] Id. at 33.
[8] Id.
[9] 33 F. Supp. 2d 1041, 1048 (S.D. Fla. 1998), aff'd per curiam, 205 F.3d 1358 (11th Cir.), cert. denied, 531 U.S. 822 (2000).

protection. The report of the House-Senate conference committee on the Riegle-Neal Act noted that "[u]nder well established judicial principles, national banks are subject to state law in many significant respects."[10] The report emphasized:

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses and communities. Congress does not intend that the Interstate Banking and Branching Efficiency Act of 1994 alter this balance and thereby weaken States' authority to protect the interests of their consumers, businesses, or communities.[11]

On the question of whether state laws may be preempted by federal banking law, the Conference Report noted that courts generally have applied "a rule of construction that avoids finding a conflict between Federal and State law where possible."

The OCC appears tone deaf to the Congressional message sent by Riegle-Neal. The OCC discounts Riegle-Neal's legislative history by noting that the Act excluded from its coverage those state laws that were preempted by federal law. While this statement is correct, the OCC ignores the fact that in 1994, when Riegle-Neal was enacted, it was generally accepted that most state consumer protection laws (outside of usury regulation) were not subject to preemption. Now that the OCC is taking the position that essentially all state consumer protection laws are preempted as to national banks, it contends that the Riegle-Neal mandate on the continued applicability of such state laws has no import. Surely, Congress did not anticipate that its stated intent could be displaced by the OCC pushing the boundaries of preemption off the map.

B. The OCC Has Established an Aggressive Pattern of Advocating Preemption of State Laws.

The OCC has, of late, undermined Congressional intent and the historic federal-state balance by promoting preemption and exclusive OCC control at every opportunity. In recent court appearances, policy statements, opinion letters and proposed rules, the OCC has articulated an intent to exempt its bank clientele from any duty to comply with state law or state consumer protection enforcement. The OCC's efforts have included reducing the traditional "significant interference" test to one of "impairing the efficiency" of a national bank; construing the "visitorial powers" of the OCC[12] to exclude any state enforcement of state laws; and using the "incidental powers" granted national banks under the NBA[13] as a catch-all preemption provision.

The OCC has been candid about its desire, for the benefit of its constituent national banks, to sweep aside the nuisance of state laws: "The ability of a national bank to conduct a multistate business subject to a single uniform set of federal laws, under the supervision of a

[10] H.R. Rep. No. 103-651, reprinted in 1994 U.S. Code Cong. & Ad. News 2068, 2074 (emphasis added).
[11] Id.
[12] 12 U.S.C. § 484.
[13] 12 U.S.C. § 24 (Seventh)

single regulator, free from the visitorial powers of various state authorities, is a major advantage of the national charter...."[14] The Comptroller has stated that the power to override state law "is one of the advantages of a national charter and I'm not the least bit ashamed to promote it."[15]

The OCC has been an assertive advocate in persuading most federal courts to ratify its aggressively expansive preemption policy.[16] In all of the recent decisions cited by the OCC as background for the proposed rule, federal courts found in favor of the OCC's position on preemption. This is hardly surprising, given the OCC's aggressive advocacy role in the federal courts.

Under the Chevron doctrine,[17] federal courts give substantial deference to federal regulatory agencies when interpreting laws enforced by those agencies. Pursuant to the Supreme Court's directive in Chevron, federal courts must exercise restraint in substituting their own construction of a statute for a "reasonable" interpretation by the appropriate agency administrator. The OCC has taken full advantage in exploiting this judicial deference, as have its regulated entities. In banking regulatory cases raising preemption issues, the OCC has repeatedly filed amicus briefs that uniformly promote the interests of the major national banks and oppose state consumer protection interests. Although some courts have questioned the OCC's motives,[18] most courts have felt bound to follow the OCC's preemption interpretations under the Chevron doctrine.

For example, in Bank One, Utah v. Guttau,[19] the OCC sided with a national bank and against the State of Iowa in opposing a state statute requiring that ATM owners maintain an Iowa office and that ATMs display the name, address and phone number of the owner. This latter requirement, intended to give consumers access to information that could help them resolve ATM operational problems, was characterized by the dissent as "a straightforward consumer protection measure."[20] Although the District Court found that the OCC's interpretation of the NBA was "unreasonable,"[21] the Eighth Circuit adopted the OCC's preemption position. In Metrobank v. Foster,[22] the OCC supported another national bank in opposing Iowa's prohibition against charging ATM fees that exceed the "interchange fees" paid to financial institutions by non-account holders.

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[14] OCC News Release 2002-10.

[15] "Dependent on Lender's Fees, the OCC takes Banks' Side Against Local Laws," Wall Street Journal, 1/28/02.

[16] One exception is the case of Bowler v. Hawke, 320 F.3d 59, 62-63 (1st Cir. 2003). The First Circuit found that an opinion issued by the OCC, which purported to declare certain Massachusetts insurance laws as preempted by the Gramm-Leach-Blilely Act, was "no more than informal agency guidance to banks and other interested parties," and did not "create a 'regulatory conflict' giving rise to a case or controversy . . ."

[17] Chevron, U.S.A., Inc., v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984)

[18] Wells Fargo Bank of Texas, N.A. v. James, 321 F.3d 488, 494 (5th Cir. 2003)

[19] 190 F.3d 844 (8th Cir. 1999), cert. denied sub nom. Foster v. Bank One, Utah, 529 U.S. 1087 (2000).

[20] Id. at 851

[21] Bank One, Utah v. Guttau, 1998 U.S. Dist. Lexis 14830 (S.D. Iowa, 1998).

[22] 193 F. Supp. 2d 1156 (S.D. Iowa 2002).

This year, in the case of Wells Fargo v. James,[23] the OCC again argued in support of a group of national banks opposed to a Texas consumer protection law. At issue in that case was a "par value" statute that prohibited any Texas bank from charging fees to cash checks drawn on that bank (known as "on us" checks). Texas contended that such check cashing charges fell disproportionately on the working poor, who often did not have their own bank at which to cash paychecks. Although the Fifth Circuit found in favor of the OCC's preemption position, it expressed concerns about the OCC's role:

> Here, the constituency positively affected by the OCC's position is concentrated, organized and well-funded, and also happens to be the regulated industry. In contrast, the constituency which is adversely affected by the decision, though vast, is diffuse, unorganized, and definitionally ill-funded. It may be that these competing interests could better be balanced, as Appellant suggests, by a national Congress whose commitments are diverse and universal, or even by the people as they are represented in the state legislatures, than by a solitary institution whose focus is a single industry.[24]

The breadth of the OCC's preemption position is revealed in recent interpretative letters issued by the Comptroller. In May 2001, the OCC issued opinions overriding Ohio and Michigan motor vehicle regulatory laws. In the Ohio opinion, the OCC authorized national banks to conduct sales of returned lease vehicles without complying with Ohio sales licensing laws.[25] Ohio law was preempted, according to the OCC, because the bank was authorized to sell the vehicles "in the manner most economically beneficial." In the Michigan opinion, the OCC found that a car dealer is not subject to the State's motor vehicle sales financing laws if a national bank is financing the sale.[26]

C. The OCC's Preemption Actions Interfere with State Consumer Protection Enforcement.

In addition to claiming that most state laws are inapplicable to national banks, the OCC essentially contends that the States do not have any consumer protection enforcement jurisdiction over national banks. The OCC does have explicit "visitorial powers" over national banks pursuant to the NBA.[27] The States therefore may not conduct bank examinations or engage in the direct supervision of a national bank. The OCC, however, is seeking to stretch the meaning of visitorial jurisdiction to block all investigations and enforcement actions directed at national banks.

The OCC has recently advised national banks to notify it if any bank is contacted by a state official, even if the state official is simply seeking information.[28] And although the visitorial powers provision in the NBA contains an express exemption for litigation ("except as ... vested in the courts of justice"), the OCC, in a recent proposed rule on visitorial powers,[29] dismisses the States' right to

[23] 321 F.3d 488 (5th Cir. 2003).
[24] Id. at 494.
[25] 66 Fed. Reg. 23977 (5/10/01).
[26] 66 Fed. Reg. 28593 (5/23/01).
[27] 12 U.S.C. § 484.
[28] OCC Advisory Letter 2002-9, 11/25/02.
[29] 68 Fed. Reg. 6366 (2/17/03).

seek legal remedies against national banks. The OCC would limit state enforcement actions to the filing of declaratory judgment actions aimed at determining whether or not the state law in question is preempted. If, then, the court finds against preemption, the OCC maintains that enforcement of a bank's compliance with the state law "is within the OCC's exclusive purview."[30]

In the past, state Attorneys General have brought consumer law enforcement actions against national banks with little controversy, just as attorneys representing private individuals have filed suit to obtain legal redress against national banks.[31] The States have routinely investigated consumer complaints against national banks and have reached formal and informal settlements with national banks. Until recently, most national banks cooperated in the resolution of these actions, and the OCC voiced no disapproval of state enforcement efforts.

In some of these actions, the States were targeting fraudulent or deceptive practices by a local retail seller. To obtain adequate relief for victimized consumers, the States have included as defendants the banking institutions that provided the financing for the questionable transactions. As the West Virginia Supreme Court noted in allowing the state Attorney General to maintain an action against a national bank that financed the allegedly unlawful sale of motor vehicle extended warranties:

> Logic and experience dictate that if the types of lawsuits which the Attorney General could bring under the CCPA did not include lawsuits against financial institutions such as defendants, these institutions could, if unsavory, run in effect a "laundry" for "fly-by-night" retailers that seek to excessively charge their consumers. Consequently, the real meaning of consumer protection would be stripped of its efficacy.[32]

The OCC has increasingly hardened its position against state enforcement rights in the past three years. In 2001, the Minnesota Attorney General brought a federal court case against Fleet Mortgage Corporation under the FTC's Telemarketing Sales Rule[33] and the Minnesota Consumer Fraud Act. Minnesota alleged that Fleet Mortgage had engaged in a deceptive marketing scheme by providing customers' private account information to third party telemarketers selling memberships in buying clubs. Fleet also added the charges for the buying club sales to customers' mortgage loan accounts.[34]

Fleet Mortgage argued that only the OCC could enforce state consumer protection laws against it. The District Court rejected Fleet's motion to dismiss, holding that "[f]ederal law does not require that the OCC have exclusive enforcement over such actions. The OCC has no direct responsibility for enforcing non-banking state laws such as the [Minnesota consumer protection

[30] Id. at 6370.

[31] See, e.g., State of Alaska v. First National Bank of Anchorage, 660 P.2d 406 (Alaska 1982); State of Arizona v. Sgrillo, 176 Ariz. 148, 859 P.2d 771 (1993); State of Wisconsin v. Ameritech Corp., 185 Wis. 2d 686, 517 N.W.2d 705 (1994); State of West Virginia v. Scott Runyan Pontiac-Buick, Inc., 194 W.Va. 770, 461 S.E.2d 516 (1995).

[32] State v. Scott Runyan Pontiac-Buick, Inc., supra, 461 S.E.2d at 526.

[33] 16 C.F.R. § 310 (promulgated pursuant to the federal Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. § 6101).

[34] State of Minnesota v. Fleet Mortgage Corp., 158 F. Supp. 2d 962 (D. Minn. 2001).

laws]."[35] Fleet, with the support of the OCC, brought a second motion to dismiss. The OCC, in its amicus brief, contended that neither Minnesota nor the FTC had any authority to enforce the Telemarketing Sales Rule against Fleet Mortgage because national banks are exempt from the Rule and the exempt status extended to non-bank subsidiaries like Fleet Mortgage. The District Court rejected the OCC's position: "The OCC's contention that it must have exclusive jurisdiction over subsidiaries in order to avoid having its authority 'restricted' is unpersuasive."[36]

There are other recent examples of States' consumer protection enforcement efforts against national banks, all of which the OCC would eliminate under its current preemption and visitorial powers stance. In some of these cases, the OCC has actively attempted to interfere with the state actions by advising banks that the States had no jurisdiction over them.

Beginning in 2001, a group of states, including California, Illinois, New York, and Florida, conducted an investigation into telemarketing operations by several major national banks. The banks had contracted with third-party telemarketers to share, for a fee, personal information about the banks' credit card customers and to provide access to bank customer billing information. The bank's name was then used in the telemarketer's sales pitch. The products sold were unrelated to the bank or to any banking services. The investigating states reached settlement agreements with Citibank and First USA despite the OCC's efforts to dissuade the banks from concluding such agreements. The OCC's view was that state Attorneys General had no enforcement authority over national banks.

In other recent examples, the Kentucky and Indiana Attorneys General have settled alleged violations of state "Do Not Call" telemarketing law violations with a national bank. The State of Arizona brought a case against an air conditioning company and Household Bank for alleged deceptive sales and financing practices targeting Spanish-speaking customers. In 2002, the States of Illinois, Maryland, and Missouri investigated an unlicensed trade school for deceptive advertising. The States questioned a national bank's role in financing tuition payments but were advised by the bank that they were preempted. The OCC confirmed the bank's view, and informed the States that the OCC alone would determine if there had been any violation of state consumer protection laws by the bank.

The proposed rule, when coupled with the OCC's pending proposed rule on visitorial powers and other OCC pronouncements, demonstrates that the OCC intends to divest the States of their traditional consumer protection enforcement jurisdiction over national banks.

D. The OCC's Proposed Rule and Other Recent Actions Undermine State Efforts to Attack Predatory Lending Abuses.

The OCC's recent preemption activity, including its order preempting Georgia's Fair Lending Law, is an unfortunate and unnecessary response to efforts by the States to control the problem of predatory mortgage lending. The States have taken a leadership role in addressing predatory lending, both in regulation and enforcement, and these state actions have been effective. The OCC should

[35] Id. at 966 (D. Minn. 2001).
[36] State of Minnesota v. Fleet Mortgage Corp., 181 F. Supp. 2d 995, 1001 (D. Minn. 2001).

recognize and support these efforts and seek to cooperate in achieving a shared goal of a fair lending marketplace.

Instead, as demonstrated by its order on the Georgia law, the OCC has found conflicts with the National Bank Act in virtually every statutory anti-predatory lending consumer protection adopted by the States. The OCC has also gone beyond assessing the impact of these laws on national banks, and has attacked the usefulness of these laws even as they apply to non-depository institutions.[37] If national banks are not subject to state laws, and if national banks are not the problem, as the OCC repeatedly asserts, then the OCC should have no reason to undermine the States' predatory lending initiatives.

The OCC's efforts to deal with the very substantial problem of predatory lending, while a step in the right direction, fall short of the actions taken by many states. In the proposed rule, the OCC takes a token and minimalist approach. The OCC's proposal addresses only asset-based lending, which is just one of the many abusive practices present in predatory lending. If the OCC intends to supplant all state laws governing predatory lending as to national banks, it should substitute a regulatory regime that more comprehensively addresses the unfair practices that are well-documented in this area. The OCC did begin to adopt a more broad based approach in Advisory Letter 2003-2, in which it recommended that banks adopt guidelines to prevent predatory lending practices. However, the OCC's general guidelines were merely advisory, intended to "encourage" national banks to adopt appropriate policies and do not carry the force of formal rules. The OCC should continue to build on the standards identified in AL 2003-2 and promulgate meaningful and specific predatory lending controls.

In every recent pronouncement the OCC has made on predatory lending, it has pointed out that a group of state Attorneys General are on record saying that most predatory lending problems have come from non-depository subprime mortgage lenders, not national banks. These statements by a group of Attorneys General were made in comments supporting a rulemaking proceeding by the Office of Thrift Supervision under the Alternative Mortgage Transaction Parity Act (AMTPA) and in an amicus brief filed in related litigation.[38] The Attorneys General supported the rational basis for OTS' distinction, in its revised AMTPA preemption rules, between "state housing creditors" and federally supervised banking institutions. The Attorneys General encouraged the OTS to revisit a prior preemption determination, and to require state housing creditors to comply with state laws regulating prepayment penalties and late fees.

It is true that most complaints and state enforcement actions involving mortgage lending practices have not been directed at banks. However, most major subprime mortgage lenders are now subsidiaries of bank holding companies (although not direct bank operating subsidiaries). Recent major settlements by state Attorneys General and the FTC related to alleged unfair lending practices by Household Finance and the Associates, both of which have now been acquired by bank holding companies. A national bank was a defendant in the only court case alleging class-wide

[37] *See* OCC News Release 2003-57 (7/24/03); OCC Working Paper, "Economic Issues in Predatory Lending," 7/30/03, available at: http://www.occ.treas.gov/workingpaper.pdf.

[38] National Home Equity Mortgage Association v. OTS, No. 02-2506 (GK) (D.D.C. 2003).

violations of North Carolina's Predatory Lending Act.[39] Several national banks have partnered with payday lenders for the sole purpose of claiming preemption authority to make very high rate, short-term consumer loans in violation of state laws. (The OCC took effective action to curtail this latter practice, known as "charter renting.") Based on these actions and other state consumer protection enforcement actions detailed above, it is clear that a national charter does not prevent a bank from engaging in unfair or deceptive practices.

State predatory lending laws have clearly identified unfair and deceptive lending practices and have imposed specific, appropriate requirements to protect consumers. The States that have enacted legislation have been sensitive to federalism concerns and have been careful not to impose direct restrictions on the rates and fees that nationally chartered lenders (or any lender) may charge. The objective in all states has been to narrowly target abusive practices and to cover only the more problematic reaches of the subprime marketplace, where borrowers are unsophisticated and where most of the problems have occurred.

Responsible lenders do not engage in the practices targeted by state predatory lending laws. These laws impose minimal burdens on legitimate lending institutions and do not impair any reasonable lending activity on the part of banks. The laws, by controlling the most abusive actors, serve to clean up the mortgage lending marketplace and restore consumer confidence, which benefits consumers and lenders alike.

In fact, many state predatory lending controls have now been voluntarily adopted by national subprime lenders. The prohibition on financing single premium credit insurance, which was considered controversial when it was included in North Carolina's 1999 law, has been accepted and implemented nationally by all of the major finance company mortgage lenders. The prohibition against flipping and the related "net tangible benefit" test, which was questioned by some lenders when it was introduced in North Carolina, also has been voluntarily adopted as a useful standard. Leading subprime lenders also have imposed restrictions on exorbitant points and origination fees, which were among the primary abuses identified in state predatory lending laws. Far from restricting the flow of credit, the predatory lending controls initially adopted by several states have become useful as bright line industry standards on a nationwide basis.

Despite the success and acceptance of state predatory lending laws, the OCC has declared every significant component of such laws to be impermissible burdens on national banks. In its order preempting the Georgia law, the OCC finds even the most non-controversial and widely accepted provisions to interfere with banks' ability to lend and therefore to be in conflict with the National Bank Act. As an example, no reasonable person would contend that encouraging a borrower to default on an existing loan is an acceptable lending practice. But just such a practice has been used by unscrupulous lenders or brokers to lead borrowers into a desperate delinquency situation, so that the borrowers then fall prey to whatever terms the lender dictates. Widely recognized as an unfair trade practice, encouraging default is prohibited by state predatory lending laws. Yet the OCC found this prohibition in the Georgia law to be preempted because it imposed

[39] Baxter v. Guaranty National Bank of Tallahassee, 01 CV 9168 (Wake County, NC Superior Court). The bank contended that the North Carolina law was preempted as to a national bank but the case was settled before this issue was judicially resolved.

impermissible restrictions on, and interfered with, "the exercise of the Federal power of national banks to make real estate loans."[40] The OCC also declared restrictions on other practices, such as negative amortization and financing of prepaid credit insurance premiums, and the requirement for high cost loan borrowers to receive credit counseling, to be similarly preempted.

If national banks do not routinely engage in practices such as encouraging default or using negative loan amortization, it is difficult to see how these consumer protections impede any bank's ability to lend. Yet under the proposed rule, any state law provision is preempted if it, among other things, 1) restricts a lender's ability to require insurance; 2) regulates anything relating to the terms of credit, including loan amortization or loan acceleration; 3) requires any disclosures; or 4) regulates advertising.

The OCC recognizes that national banks are subject to Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive trade practices.[41] Most states have similarly worded consumer protection statutes, many modeled on the FTC Act. If national banks are prohibited from engaging in unfair and deceptive practices under federal law, then it should be no impediment for them to comply with state laws proscribing the same unlawful practices. State predatory lending acts apply the States' unfair and deceptive practices regulatory authority to the field of mortgage lending. These statutes give further definition and more precise guidelines for lenders on fair conduct in making mortgage loans to consumers.

In the experience of the States, lenders welcome bright line tests more than general proscriptions against unfair conduct. However, in adopting its own very limited restrictions on predatory lending, the OCC falls back on compliance with the FTC Act as a standard for lenders to follow. The OCC would be better advised to fall back on the numerous state laws and regulations in this area and to develop more useful rules for the benefit of the banking industry and consumers alike. The OCC also should insist that national banks comply with state predatory lending laws unless there is compelling evidence that such compliance substantially interferes with a bank's ability to make real estate loans.

E. The OCC Has Exceeded its Authority in Extending Preemption Rights to the Operating Subsidiaries of National Banks.

The OCC's proposal to apply its overly broad preemption rules to operating subsidiaries of national banks clearly exceeds its authority under the National Bank Act. The proposal would do great damage to the state-federal dual banking system, and should be withdrawn.

Operating subsidiaries are not national banks subject to a national charter; they are state-created entities incorporated under state law and have been licensed and regulated by the States for years without controversy. Nothing in the NBA grants the OCC power to bar states from licensing, examining and otherwise regulating state-created non-bank entities that happen to be subsidiaries of national banks. Nevertheless, the OCC now proposes that operating subsidiaries of national banks should have the same legal and regulatory status as the national banks themselves, contending

[40] 68 Fed. Reg. 46278 (8/5/03).

[41] 15 U.S.C. § 45(a)(1).

that these subsidiaries are effectively departments, divisions or equivalent parts of the banks.

The OCC proposes to federalize state-chartered subsidiaries by placing them within the exclusive supervisory control of the OCC. Under the OCC's proposal, the States would be deprived of all authority to regulate these state-chartered corporations, which include mortgage companies that have long been licensed by States. The OCC proposal intrudes upon the States' sovereign powers and exceeds the boundaries of federal authority under the Tenth Amendment. It attempts to convert state-chartered corporations into creatures of federal law without permission of the chartering states.[42]

According to the OCC, a state law is exempted from preemption only if it is expressly incorporated into the federal banking laws or has no more than an "incidental" effect on banking activities. The OCC, however, considers mere inconvenience to a subsidiary of a national bank to be a conflict between federal and state law. As indicated by amicus curiae briefs filed by the OCC across the country, this overreaching standard would lead to the preemption of nearly all state licensing and regulatory laws. The preemption of state licensing laws, including the ability to license and examine mortgage lending entities, is not sound public policy. It would encourage financial institutions to give up their state charters, and to instead, seek either to obtain a federal charter or to merge with a national bank, effectively destroying the dual banking system that is valued by both Congress and the States.

Operating subsidiaries historically have been regulated by States under their respective laws and relevant regulatory regimes and are in no manner considered "national banks" by the NBA. Moreover, the NBA provides absolutely no basis for ignoring the corporate distinctions between a parent national bank and its subsidiary. In an area where, as here, state law traditionally has applied, Congressional intent to preempt state law must be clearly manifested.[43] There is no such intent expressed anywhere in the NBA, and the OCC's proposal is, in fact, contrary to Congressional intent, expressed most recently in the legislative history of the Riegle-Neal Interstate Banking Act.[44]

Additionally, the NBA provides stringent requirements for banks to qualify as national banks. None of these requirements apply to their state-chartered and state-regulated operating subsidiaries. Instead, as creatures of state law, operating subsidiaries should comply with applicable state law requirements.

Moreover, the States have long held an unquestioned primacy in regulating state-chartered corporations, particularly including companies that engage in consumer financial services. Courts have repeatedly upheld States' authority to exercise comprehensive supervision over the corporations they charter and to license and regulate corporations chartered by other states that transact business within their borders. As affirmed by the Supreme Court, "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations."[45] The

[42] Hopkins Federal Savings & Loan Ass'n v. Cleary, 296 U.S. 315 (1935).
[43] English v. General Electric Co., 496 U.S. 72, 74 (1990); California v. ARC American Corp., 490 U.S. 93, 101 (1989); Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977).
[44] See discussion in Section II.B. at pp. 4-5 above.
[45] CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 89 (1987).

fact that a state-chartered corporation is an affiliate of a national bank does not alter the principles of federalism that grant States the right to regulate corporations chartered under their laws. Indeed, in a case where the OCC similarly engaged in an overly aggressive interpretation by the OCC of the NBA, a federal circuit court of appeals concluded that "to defer to the OCC in this case would flout Congressional intent – something we remain unwilling to do."[46]

The OCC's claim of exclusive supervisory powers over operating subsidiaries is contrary to both this nation's dual system of banking and the historic primacy of the States in matters of corporate governance. The OCC's broad assertion of field preemption has no basis in any of the federal legislation that provide that agency with its regulatory authority. Like the OCC's claims of complete preemption with respect to national banks, the OCC's proposal to extend its hegemony to banks' operating subsidiaries wholly exceeds any reasonable interpretation of the regulatory powers given to the OCC by national banking laws. The OCC's proposal to create such a sweeping standard of preemption and to bar the States from regulating subsidiaries of national banks created under state laws directly violates Congressional intent, federal law and the Tenth Amendment to the Constitution.

In conclusion, the OCC's proposed rules represent a significant expansion of preemption standards and a restructuring of the federal-state balance that has existed for many years, particularly in the area of consumer protection. For the reasons expressed above, we urge the OCC to withdraw the proposed rules.

We thank you for the opportunity to submit these Comments. If you have questions or comments, please do not hesitate to contact Sarah Reznek, NAAG's Consumer Protection Project Director, at (202) 326-6016 or Blair Tinkle, NAAG's Legislative Director, at (202) 326-6258.

Respectfully,

Bill Pryor

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[46] American Land Title Association v. Clarke, 968 F.2d 150, 157 (2d Cir. 1992).

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April 8, 2003

Via Facsimile - (202) 874-4448

Office of the Comptroller of the Currency
250 E Street, SW
Public Information Room
Mailstop 1-5
Washington, DC 20219
Attn: Docket No. 03-02

Dear Sir or Madam:

The National Association of Attorneys General (NAAG) wishes to file the attached Comments in response to the Office of Comptroller of the Currency's notice in the Federal Register regarding the clarification of its existing rule concerning the agency's exclusive visitorial powers to examine, supervise, and regulate national banks.

If you have any questions or comments, please do not hesitate to contact Sarah Reznek, NAAG's Consumer Protection Counsel, at (202) 326-6016 or Blair Tinkle, NAAG's Legislative Director, at (202) 326-6258. Thank you for your attention to this matter.

Sincerely,

Lynne Ross

Lynne Ross
Executive Director

Attachment

COMMENTS AND RECOMMENDATIONS
OF THE ATTORNEYS GENERAL OF:

Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Vermont, the Virgin Islands, Virginia, Washington, West Virginia, and Wisconsin, and the Corporation Counsel of the District of Columbia

I. INTRODUCTION AND SUMMARY

We, the undersigned Attorneys General, submit these comments as requested in the Notice of Proposed Rule Making ("NPRM") by the Office of the Comptroller of the Currency ("OCC") published in the Federal Register on February 7, 2003. These comments specifically object to the OCC's proposed reinterpretation of the "visitorial powers" provision of the National Bank Act.[1]

The OCC's proposed modifications to its regulations could exclude State Attorneys General from enforcing laws of general application, including state consumer protection laws, against banks chartered by the OCC. The OCC considers such enforcement as an exercise of visitorial powers within its exclusive authority. While the Attorneys General welcome the efforts of other law enforcement agencies to enforce consumer protection laws on behalf of victimized consumers, we are deeply troubled by any efforts to divest the States of their historic role in protecting their residents from consumer fraud by all merchants, regardless of type. Consumers need more consumer advocates to enforce the laws in this area, not fewer.

The OCC declares in the Federal Register comment that the National Bank Act "protect[s] national banks from potential state hostility... "[2] When we as Attorneys General enforce the laws on behalf of the residents of our States, we do not undermine banks but rather protect both consumers and business competitors from those that engage in deceptive acts and practices and unfair competition.

The Attorneys General believe that states enjoy shared jurisdiction with the OCC to enforce consumer protection laws against national banks. As set forth in more detail below, Congress defined "visitorial powers" narrowly to encompass only administrative bank examinations rather than litigation of claims. States have historically enforced consumer protection laws against national banks with no objection from the OCC, and federal and state courts have consistently and recently upheld State enforcement of those laws. We believe the proposed regulation exceeds the scope of Congressional authority, misinterprets the National Bank Act, and reflects a change in the OCC's historic position. In order to promote joint enforcement and to protect consumers who interact with national banks, we urge the OCC to retract the proposed changes to 12 C.F.R. § 7.4 in their entirety.

II. THE PROPOSED RULE

The OCC issued an advisory letter on November 25, 2002, which elaborated publicly and officially, for the first time, the agency's revised position that State Attorneys General are precluded from enforcing consumer protection laws against national banks. On February 7, 2003, the OCC published a proposed rule for notice and comment that would significantly alter the current rule in two ways: 1) broadening the OCC's exclusive visitorial authority to include "all activities expressly

[1] 12 U.S.C. § 484.
[2] 68 Fed. Reg. at 6367, 6369.

authorized or recognized as permissible for national banks under Federal law or regulation ..."; and 2) eliminating the explicit statutory provision permitting States to file lawsuits against national banks.

III. THE STATUTORY FRAMEWORK

A. "Visitation" means examination for compliance with banking laws rather than enforcement of laws of general application

Congress established the OCC in 1864 to "regulate the national currency."[3] The main function of the agency is to prevent "unsafe and unsound banking practices."[4] In order to provide a method of preventing unsound practices specifically related to banking, Congress in 1864 established an examination system for national banks:

> *And be it further enacted*, That the Comptroller of the Currency with the approbation of the secretary of the Treasury, as often as shall be deemed necessary or proper, shall appoint a suitable person or persons to make an examination of the affairs of every banking association, which persons shall not be a director or other officer in any association whose affairs he shall be appointed to examine, and who shall have power to make a thorough examination into all the affairs of the association, and in so doing so to examine any of the officers and agents thereof on oath; and shall make a full and detailed report of the condition of the association to the Comptroller. And the association shall not be subject to any other visitorial powers than such as are authorized by this act, except such as are vested in the several courts of law and chancery.[5]

The OCC conducts these examinations to review bank records for compliance with banking laws.[6] Congress thus delegated "visitorial powers" to the OCC in the context of these bank examinations.[7]

The current codification of the National Bank Act confirms the intent of the 38th Congress. The visitorial powers section of the National Bank Act is codified in a subchapter entitled "Bank

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[3] 12 U.S.C. § 1.

[4] 12 U.S.C. § 1818.

[5] Cong. Globe, 38th Cong. 1st Sess., 1432-33 (Apr. 7, 1864).

[6] See, e.g. http://www.occ.treas.gov/aboutocc.htm. "National bank examiners supervise domestic and international activities of national banks and perform corporate analyses. Examiners analyze a bank's loan and investment portfolios, funds management, capital, earnings, liquidity, sensitivity to market risk, and compliance with consumer banking laws, including the Community Reinvestment Act. They review the bank's internal controls, internal and external audit, and compliance with law. They also evaluate bank management's ability to identify and control risk."

[7] See Guthrie v. Harkness, 199 U.S. 148, 158 (1905), for a definition of "visitorial powers" in this regard.

Examinations."[8] The provisions surrounding this section address such technical issues as appointment and payment of examiners,[9] special examinations,[10] and waiver of examination requirements.[11] Although Section 484 prevents state banking commissioners from exercising examination authority over national banks, it does not authorize the exclusion of any other governmental entity from enforcing laws of general application in judicial actions against national banks.

Until recently, the OCC has held the same view and has interpreted the "visitorial powers" provision in accordance with the limited Congressional grant of authority. When the OCC engaged in rulemaking on 12 C.F.R. § 7.4000 in 1996, the Comptroller discussed the rule in a section entitled "Books and Records of National Banks" and further declared that the provision addressed "the exclusive examination authority of the OCC."[12] As defined by Congress and the OCC, "visitorial powers" limit other agencies from reviewing bank records through examinations; those powers do not limit other agencies from a review of records outside of the narrow context of examinations.

The plain meaning of the word "visitation" further supports our position. Visitation is "the act of a superior or superintending officer."[13] Courts that have construed the definition of the term "visitorial" have focused on the specific regulation of an entity rather than on efforts to apply laws of general application.[14] The Attorneys General of the States do not seek to superintend national banks; rather, they seek to enforce laws of general application when national banks violate those laws.

Consistent with the National Bank Act, "visitation" means examination for compliance with banking laws. In a March 5, 2003 letter to Attorneys General, the Comptroller disputes this contention by reference to Section 484(b) of the Act, which permits state auditors to review bank records to ensure compliance with state unclaimed property laws. The Comptroller claims that Congress intended this section as an exception to an otherwise broad reading of the term "visitation."

The Comptroller, however, misreads the history underlying Section 484(b). As a threshold matter, Section 484(b) in no way defines examination for compliance with State unclaimed property laws as "visitation." Section 484(b) was one of numerous "technical corrections in certain banking and related statutes" made, without any legislative history, as part of an omnibus bill in the 97th

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[8] 12 U.S.C. § 484(a), codified in Subchapter XV of Title 12 of the United States Code.

[9] 12 U.S.C. §§ 481-82.

[10] 12 U.S.C. §§ 483 and 485.

[11] 12 U.S.C. § 486.

[12] 61 Fed. Reg. 4849, 4858 (February 9, 1996) (emphasis added).

[13] Guthrie, 199 U.S. at 158.

[14] E.g. Best v. National Bank of Oregon, 739 P.2d 554, 563 (Or. 1987) (holding, in a case challenging bank fees, that a review of bank records "would not be an exercise of visitorial powers because these actions would not be for the purpose of regulation."); State v. First Nat. Bank of St. Paul, 313 N.W.2d 390 (Minn. 1981).

Congress.[15] Notably, Section 484(b) was added to the National Bank Act only after a state court in Minnesota declared that audits for compliance with unclaimed property laws were not visitorial in nature.[16] The court concluded that visitorial powers were limited to those examinations designed to: 1) ascertain the "financial condition and soundness" of banks; 2) determine compliance with banking laws; and 3) enable the Comptroller to recommend changes to banking law.[17] None of these purposes are frustrated by examination for unclaimed property, and none are frustrated by consumer fraud litigation.

The distinction between compliance and litigation is particularly relevant when we consider the rights of private individuals. The OCC acknowledges that private individuals may litigate private rights of action against national banks.[18] Thus, according to the OCC, residents of our States may litigate, individually or as a class, consumer fraud claims against national banks. If these residents may litigate against national banks, then they may subpoena documents and records as necessary to prove their claims and may seek all the rights and remedies against national banks, including damages and injunctive relief, which our consumer fraud statutes permit. We agree that individuals may sue national banks in state courts for violations of state consumer protection laws, but believe it is faulty logic and poor policy to assert that State Attorneys General cannot do the same. Further, if the review of bank documents in a private enforcement action is not visitorial in nature, then the review of bank documents in a public enforcement action also must fall outside of the "visitorial powers" limitation.

B. Enforcement of State laws in court is expressly permitted by the National Bank Act

Consistent with the 1864 enabling act,[19] the National Bank Act still contains an exception to the visitorial powers limitation for all actions "vested in the court of justice."[20] This exception is consistent with the exclusive yet limited grant of authority to the OCC to conduct examinations.[21] Courts have declared that only the OCC may examine a national bank for compliance with banking laws, but have also recognized that any individual or government entity may litigate laws of general application against national banks.[22] "Undoubtedly a state has the legitimate power to define and punish crimes by general laws applicable to all persons within its jurisdiction."[23]

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[15] See 1983 S.J. Res. 271, P.L. 97-457, 96 Stat. 2507 (January 12, 1983).

[16] St. Paul, 313 N.W. 2d at 394.

[17] Id. at 395.

[18] 68 Fed. Reg. at 6370.

[19] Cong. Globe, 38th Cong. 1st Sess., 1432-33 (Apr. 7, 1864).

[20] 12 U.S.C. § 484(a).

[21] The OCC declares in n.15, without any support, that judicial enforcement was the most common means of exercising the visitorial power in the 1860s. That cannot be true. Visitorial power was and is exercised through examinations, and there is no evidence that OCC examinations were ever conducted through the courts.

[22] E.g. First Nat. Bank v. Kentucky, 76 U.S. 353, 362 (1869); Easton v. Iowa, 188 U.S. 220, 239 (1902); Guthrie, 199 U.S. at 159; Best, 739 P.2d at 563; St. Paul, 313 N.W. 2d 390.

[23] Easton, 188 U.S. at 239.

One case cited by the OCC, National State Bank v. Long,[24] presents a far different set of facts. In Long, the court prohibited a state banking commissioner from issuing an administrative cease-and-desist order against a national bank for violating a state banking law. Long does not address litigation by Attorneys General under laws of general application. When Attorneys General bring consumer protection enforcement actions against national banks, we do so as the States' chief law enforcement officers rather than on behalf of a banking commissioner, and we are authorized to do so by applying for relief to a court. Later courts, while upholding the OCC's exclusive authority to administratively enforce banking laws, have contrasted permissible enforcement actions brought by States directly in court.[25]

IV. THE LEGITIMATE INTERESTS OF THE STATES TO ENFORCE CONSUMER PROTECTION LAWS AGAINST BUSINESSES THAT ENGAGE IN DECEPTIVE ACTS AND PRACTICES

A. Congress has declared that the States have an interest in protecting consumers from deceptive acts and practices of national banks

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 does not call into question state authority to enforce laws of general application. Riegle-Neal was adopted to permit national banks to operate interstate branches to better serve consumers. Because Riegle-Neal extended OCC jurisdiction over branch banks, it also provided for the first time a grant of authority to the OCC to enforce state consumer protection laws against branches of national banks.

The assertion that Congress granted exclusive authority has no basis.[26] Riegle-Neal's legislative history recognizes the critical role that states play in protecting consumers, and makes it clear that the Act did not in any way limit the ability of states to enforce their consumer protection laws against national banks. The Conference Report issued upon final passage of the Riegle-Neal Act explicitly recognizes the authority of states to protect their consumers:

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses, and communities. Federal banking agencies, through their opinion letters and interpretive rules on preemption issues, play an important role in maintaining the balance of Federal and State laws under the dual banking system. Congress does not

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[24] 630 F.2d 981 (3rd Cir. 1980).

[25] E.g. First Union Nat. Bank v. Burke, 48 F. Supp. 2d 132, 144 (D. Conn. 1999).

[26] The statute states only that the provisions of any State law shall be enforced by the Comptroller. In light of the legislative history, that statement is a Congressional mandate that the Comptroller engage in consumer protection efforts rather than a declaration of exclusive OCC enforcement jurisdiction.

> intend that the Interstate Banking and Branching Efficiency Act of 1994 alter this balance and thereby weaken States' authority to protect the interests of their consumers, businesses, or communities.[27]

The term "protect" is consistent with the continued exercise of enforcement authority by Attorneys General with respect to national banks.[28]

B. State Attorneys General have historically litigated consumer fraud enforcement actions against national banks

The comments to the NPRM present the appearance that State Attorneys General have only recently begun enforcement efforts against national banks. State Attorneys General can and have brought consumer fraud enforcement actions against national banks to the same extent as lawyers representing private individuals, and this enforcement authority has never been successfully challenged by national banks under the exclusive visitorial authority theory.

State Attorneys General have routinely litigated consumer fraud actions against national banks and related entities;[29] indeed, it would be difficult to obtain full relief in many consumer fraud cases if one bad actor among many were excluded from the jurisdiction of the court:

> Logic and experience dictate that if the types of lawsuits which the Attorney General could bring under the CCPA did not include lawsuits against financial institutions such as defendants, these institutions could, if unsavory, run in effect a "laundry" for "fly-by-night" retailers that seek to excessively charge their consumers. Consequently, the real meaning of consumer protection would be stripped of its efficacy.[30]

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[27] Conf. Rep. 103-651 (1994), *reprinted in* 1994 U.S.C.C.A.N. 2068, 2074 (emphasis added.)

[28] Although we focus here on consumer protection, we note that the OCC's reading of Section 484 is so expansive that it calls into question the continued enforcement of numerous other laws of general applicability. For example, proposed new section 7.4000(b)(2) asserts that the exception for powers "vested in the courts of justice" does not authorize state or other governmental entities to compel "adherence to restrictions or requirements concerning the content of [the activities of national banks] or the manner in which, or standards whereby, those activities are conducted." Enforcement of such state or local laws and regulations as labor laws, zoning and land use ordinances, or environmental regulations arguably compels adherence to requirements or regulates the manner or standards by which national banks conduct their activities.

[29] See, e.g. State v. First Nat'l Bank of Anchorage, 660 P.2d 406, 426 (Alaska 1982) (holding that the Alaska Attorney General could sue a national bank); Attorney General v. Michigan Nat'l Bank, 312 N.W.2d 405, 414 (Mich. App. 1981), overruled on other grounds 325 N.W.2d 777 (Mich. 1982) (holding that a national bank could be held liable by the Attorney General under state and federal consumer protection laws related to mortgage escrow accounts); see also State ex rel. Woods v. Sgrillo, 859 P.2d 771 (Ariz. App. 1993) (listing Valley National Bank as a defendant in the caption); State v. Ameritech Corp., 517 N.W.2d 705 (Wis. App. 1994), aff'd 532 N.W.2d 449 (Wis. 1995).

[30] State v. Scott Runyan Pontiac-Buick, Inc., 461 S.E.2d 516, 526 (W Va. 1995).

If State Attorneys General are divested of enforcement authority, consumers will lose important protections.

C. The OCC has historically deferred consumer protection claims against national banks

We welcome the OCC's recent efforts at consumer protection through administrative enforcement, but those efforts cannot supplant the efforts and achievements of the States, both in terms of individual litigation and multistate settlements. The OCC has a more limited view of the relief available to consumer victimized by consumer fraud than that regularly obtained by State Attorneys General under their consumer protection laws. An assertion of exclusive enforcement authority in this context significantly weakens the relief available to consumers through litigation by the Attorneys General.

D. All Courts that have considered the issue have rejected exclusive jurisdiction defenses raised by national banks in consumer protection claims brought by State Attorneys General

To date, courts in Minnesota, Texas, and Arizona have addressed the "exclusive jurisdiction" theory in cases brought by Attorneys General to enforce general consumer protection laws. In Minnesota, the federal district court denied a motion to dismiss brought by Fleet National Bank.[31]

> The fraud and deceptive trade practice laws at issue do not directly concern a banking practice and the alleged illegal actions are not banking industry specific. Federal law does not require that the OCC have exclusive jurisdiction over such actions.[32]

In Texas and Arizona, state trial and appellate courts denied motions to dismiss brought by Household Bank (S.B.), N.A.[33] Given that courts in multiple jurisdictions, and in both the federal and state systems, have rejected the "exclusive jurisdiction" theory, we believe that the OCC should reject it as well.

V. THE PROPOSED RULE WOULD PRESENT A SERIOUS ISSUE OF VALIDITY IN A COURT CHALLENGE

Under traditional standards of administrative law, a final rule issued by the OCC might be entitled to deference by a court considering the validity of the rule. Due to the divestiture of State

[31] Fleet, 158 F. Supp. 2d at 966.

[32] Id.

[33] State v. Household Bank, CV2000-003625 (Maricopa County Super. Ct. September 18, 2001), special action review denied, 1 CA-SA 01-0275 (Ariz. App. November 21, 2001); Household Retail Services, Inc. & Household Bank (SB), N.A. v. State of Texas, 2001 WL 984779 (Tex. App. August 29, 2001).

jurisdiction and the change in the OCC's previous position, state and federal courts will be reluctant to give such deference to the proposed modification.

A. Agency actions that enlarge agency jurisdiction may not receive deference

Many courts refuse to provide deference to agency interpretations that enlarge the agency's own jurisdiction.[34] "If there is any manner of statutory construction in which the judiciary should not defer to an administrative agency, it is in defining the parameters of the agency's authority under the statute. The agency should not be the arbiter of its own jurisdictional limits."[35] This is particularly true where, as here, the agency's exercise of jurisdiction would "lead to the complete ouster of state authority." [36]

B. Agencies that change position are entitled to "considerably less deference"

The OCC has only recently developed its exclusive jurisdiction theory. As discussed in Sections III and IV, supra, the OCC never objected to Attorney General exercises of jurisdiction in the past. Furthermore, the OCC itself declared that "visitorial powers" focused on the exclusive examination authority of the OCC.[37] The NPRM reflects a changed position. Agencies that change their positions have been granted less deference.[38]

> An additional reason for rejecting the INS's request for heightened deference to its position is the inconsistency of the positions the BIA has taken through the years. An agency interpretation of a relevant provision which conflicts with the agency's earlier interpretation is "entitled to considerably less deference" than a consistently held agency view.[39]

C. The National Bank Act is unambiguous

When courts are confronted with a challenged agency interpretation of a statute that the agency administers, they first look to whether or not Congress has spoken, and then, only if Congress has not spoken, to whether or not the agency interpretation is a permissible construction

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[34] See, e.g. Brown & Williamson v. FDA, 153 F.3d 155, 162 (4th Cir. 1998), aff'd 529 U.S. 120 (2000); Minnesota Transp. Regulation Board v. ICC, 966 F.2d 335, 338 (8th Cir. 1992); California Rural Legal Assistance, Inc. v. Legal Services Corp., 937 F.2d 465, 466 (9th Cir. 1991) (concurring opinion).

[35] California Rural Legal Assistance, 937 F.2d at 466 (concurring opinion).

[36] Minnesota Transp. Regulation Board v. U.S., 966 F.2d at 338, citing to County of Marin v. U.S., 356 U.S. 412, 419 (1958).

[37] 61 Fed. Reg. at 4858.

[38] INS v. Cardoza-Fonseca, 480 U.S. 421, 430 n.30 (1987).

[39] Id.

of the statute.[40] In this case, Congress has spoken, both in 1864 and in 1983 during the last revision of Section 484:[41] national banks may be subjected to any powers vested in the courts of justice. This statute is not in any way ambiguous. Furthermore, even if a court did not recognize the clear limitations on the Congressional grant of authority, less deference to agency gap-filling is appropriate on important questions of law.

> In extraordinary cases, however, there may be reason to hesitate before concluding that Congress has intended such an implicit delegation. A court may also ask whether the legal question is an important one. Congress is more likely to have focused upon, and answered, major questions, while leaving interstitial matters to answer themselves in the course of the statute's daily administration.[42]

Divesting Attorneys General of the power to assist consumers defrauded by national banks is a major question, and one likely to receive extensive scrutiny from any reviewing court.

VI. CONCLUSION

The Attorneys General of the States view our consumer protection responsibilities seriously, in order to protect consumers from the effects of deceptive acts and practices. We do not intend to invade the OCC's exclusive area of bank examinations to ensure compliance with federal banking law. Outside of that narrow area, however, we will employ all the tools at our disposal to protect consumers through enforcement of state laws of general application. We have in the past and will continue in the future to investigate and litigate claims against all businesses who deceive our consumers, including banks chartered by the OCC. We urge the OCC to retract its NPRM, and to share jurisdiction with the Attorneys General as advocates for consumer protection.

Respectfully,

Attorney General Gregg Renkes
Attorney General of Alaska

Attorney General Terry Goddard
Attorney General of Arizona

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[40] Chevron USA v. National Resources Defense Council, 467 U.S. 837, 843-45 (1984).

[41] Cong. Globe, 38th Cong. 1st Sess., 1432-33 (Apr. 7, 1864); 12 U.S.C. § 484(a).

[42] Brown & Williamson, 529 U.S. at 159 (internal citations omitted).

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Statement of Hilary Shelton
Director
Washington Bureau of the
National Association for the Advancement of Colored People
Before the U.S House of Representatives
Committee on Financial Services
Subcommittee on Oversight and Investigations
Hearing on "Congressional Review of OCC Preemption"
January 28, 2004

Thank you, Chairwoman Kelly, Congressman Frank, Congressman Gutierrez, and to all the members of the full committee and the subcommittee for inviting me here today. I appreciate the opportunity to provide you with the views of the National Association for the Advancement of Colored People (NAACP) on this very important matter.

My name is Hilary Shelton and I am the Director of the Washington Bureau of the NAACP. The Washington Bureau is the federal policy arm of our nation's oldest, largest and most widely-recognized grassroots civil rights organization. With more than 2,200 membership units in every state in our nation, the NAACP knows that predatory lending, which is rampant in our communities, hurts individuals, destroys neighborhoods, and poses a real risk to our nation's future.

Let me begin by saying that the NAACP is strongly opposed to the new regulations issued by the Office of the Comptroller of the Currency, as they will clearly eviscerate the limited protections that we currently have in place in a few states to begin to address the scourge of predatory lending. Furthermore, as put forth by the OCC, the new regulations will, in fact, exacerbate a broken financial system which results in prolonged poverty and the targeting of individuals and neighborhoods because of their racial or ethnic make-up.

Predatory lending is clearly a major civil rights issue. As several studies have shown, predatory lenders prey on African Americans and other racial and ethnic minorities in vastly disproportionate numbers. Two important reports from 2002 showed that "African Americans were 4.4 times more likely to receive a subprime loan, and Latinos were 2.2 times more likely to do so" than their white counterparts[1], and that "the disparity (in subprime loans) between whites and African-Americans and other minorities actually grows at upper-income levels

[1] ACORN, "*Separate But Unequal: Predatory Lending in America*", November, 2002

and is greater for higher-income African-American homeowners than for lower-income white homeowners."[2]

Another, more recent study from the National Community Reinvestment Coalition shows that the trends identified have not abated, and that "...discrimination is widespread in America...African-American and predominantly elderly communities receive a considerably higher level of high cost subprime loans than is justified based on the credit risk if neighborhood residents."[3]

All of these studies bear out a fact that the NAACP has known for years through our grassroots efforts at increasing homeownership in our communities and through personal experiences: African Americans are disproportionately targeted by predatory lenders for subprime loans, and the results are incredibly destructive. And the problem appears to be getting worse.

It is because of the disparate, and frankly injurious, manner in which some financial institutions continue to deal with the African American community that the NAACP has, at the national, state and local level pushed for stronger anti-predatory lending laws.

In the interest of time, Madame Chairwoman, I am asking that two recent NAACP resolutions dealing with predatory lending which were included in my written testimony be inserted into the record. I would call special attention to the resolution passed in February of last year, which specifically states the NAACP's opposition to federal preemption of state laws.

So why is the NAACP so opposed to the federal preemption of state laws, and specifically to the OCC's recent action? Put simply, by preempting state and local anti-predatory lending laws, the OCC is effectively doing away with the few protections we have been able to put in place to address the scourge of predatory lending.

The only way we can truly put a dent in the problems that result from predatory lending is to change the mortgage lending marketplace, so as to make predatory loans too risky, too expensive for lenders, and no longer good financial investments. We must take away the monetary incentives to make predatory loans.

It is true that historically, national banks have been less likely to perpetrate predatory lending practices. This does not mean, however, that national banks and their subsidiaries do not participate in, or profit from, predatory lending. On

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[2] Center for Community Change, "Risk *or Race? Racial Disparities and the Subprime Refinance Market*", May, 2002, p.1

[3] The National Community Reinvestment Coalition, "*The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age*", December, 2003, p.4

the contrary, there are numerous cases in which national banks, their operating subsidiaries or their affiliates have clearly profited from predatory lending.[4]

National banks, their subsidiaries and their affiliates profit from predatory lending practices in numerous ways, including: making direct loans, buying predatory loans from brokers, investing in loan portfolios that contain predatory loans, and providing securitization services for trusts which contain predatory loans.

Because the federal government has, frankly, done little to make it less profitable for banks to engage in predatory lending or at least supporting predatory lending, several states have stepped in to protect their citizens. I must point out that all of these laws were enacted only after research, extensive debate and negotiations, and many were made with local economic conditions and concerns in mind.

Yet the OCC is exempting national banks and their subsidiaries from these protections without offering any real alternative protections from predatory lending. While the regulation, as we understand it, does offer a few new protections, they are incredibly weak and will clearly not even begin to be as effective against predatory lending as many of the state laws, including those in North Carolina, Georgia, New Jersey and New York to name a few.

Furthermore, the list of state laws that will be preempted by this new regulation is long and, in many cases, very vague. When closely scrutinized, it is clear that under the new regulation the OCC intends to preempt national banks and their operating subsidiaries from hundreds, and potentially thousands, of consumer protection and anti-predatory lending laws. This means that instead of all fifty state attorneys generals, all fifty state offices of consumer protection, and all the private attorneys who may bring suits against banks under state laws, enforcement of very vital and necessary consumer protection and anti-predatory lending laws will be left up to the OCC's Consumer Advisory Group, an office of 22 people located in Texas.

Thus 22 people, located in one office in one city in one state will be responsible for monitoring and enforcing against the predatory lending actions of thousands of financial institutions across the nation. The exact number of financial institutions for which these 22 individuals will be responsible is unclear: suffice it to say, however, that according to the OCC there are more than 2,500 national banks[5], and one of the largest, Wells Fargo, had 76 operating subsidiaries that engaged in consumer mortgage lending in May of 2002,[6] the most recent data we were able to obtain.

[4] See the comments of the National Consumer Law Center and the Consumer Federation of America, National Association of Consumer Advocates and the US Public Interest Research Group to the OCC's proposed regulations, Docket No. 03-16, October 6, 2003, pp. 7-12, for a partial list of pending and closed cases involving national banks or their operating subsidiaries or affiliates where violations of law and/or predatory practices are alleged.

[5] OCC website: www.occ.treas.gov

[6] United States Senate Banking committee staff

In other words, rather than a multitude of regulators and watchdogs located throughout the nation and our communities monitoring the behavior of national banks and their subsidiaries, enforcement of anti-predatory lending laws will be left to a few individuals. Thus, not only does the NAACP decry the evisceration of many of the state laws that are protecting our members and our communities from predatory lending, but we are also extremely troubled by the practical impact of this new regulation: the few laws that are left that protect us will, frankly, not be enforceable.

Predatory lending has ruined individuals' lives, communities, and represents a real threat to our nation's continued economic well being. As a result of predatory lending, millions of Americans across our nation have lost their homes and their primary source of savings. We should be taking more proactive steps to address this problem and expanding on the initiatives advanced by state laws, not exempting a whole class of financial institutions from state regulations that protect individual consumers.

As I said in the beginning of my testimony, predatory lending is clearly a civil rights issue, given the egregious way in which racial and ethnic minorities are targeted by some financial institutions for predatory loans. The fact that the Office of the Comptroller of the Currency does not appear concerned about the disparities that exist in our nation's financial arena today, and in fact has chosen to belittle the problems of our communities by exempting national banks and their subsidiaries from laws intended to address this problem, is alarming and insulting to the NAACP and the communities we serve, to say the least.

By putting these regulations in place, the OCC is setting a precedent to allow some national banks to continue to target racial and ethnic minorities and the elderly for their own monetary gain. This is contrary to the long-held view of the NAACP that the primary responsibility of the government is to protect its citizens, all of its citizens, not to exploit them for the gain of a few.

There has been lots of talk and debate about whether the OCC has the legal authority to preempt state predatory lending laws. I am sure that this debate will continue for some time. I will not even begin to enter that fray.

One thing should be clear, however: regardless of the outcome of the debate over legal authority, the OCC clearly does not have the moral authority to take this action.

I would like to again thank the members of the subcommittee for their interest in this matter, and for inviting me here today to share with you the opinions of the NAACP. I welcome any questions.

Attachment I: NAACP Resolution passed t the National Convention, July 2002, Houston, TX

ECONOMIC DEVELOPMENT [ADOPTED]

1. **Predatory Lending and Payday Lending Practices**
   Vance, North Carolina Branch

Concurred as Amended

WHEREAS, the economic status of African-Americans in general is worse than that of white Americans; and

WHEREAS, the net worth of African-Americans is approximately 10% of that of white Americans; and

WHEREAS, many African-Americans, as well as other minorities and low-wealth citizens struggle each day to meet basic needs; and

WHEREAS, wages have not kept pace with the cost of living; and

WHEREAS, the credit needs of African-Americans and other low-wealth citizens is evident in the disparities between net worth, as well as income, and the overall cost of living; and

WHEREAS, many financial institutions, including responsible lenders in the subprime sector, are knowledgeable of the credit needs of the low-wealth population and many have responded responsibly; and

WHEREAS, these credit needs are now targeted and exploited by a growing number of predatory and payday lenders; and

WHEREAS, these predatory and payday lenders are concentrated in the subprime sector; and

WHEREAS, a recent study by the U.S. Department of Housing and Urban Development showed that borrowers in African-American neighborhoods are five times more likely to get a loan from a subprime lender – and therefore pay more – than borrowers in white neighborhoods; and

WHEREAS, borrowers in upper-income African-American neighborhoods are twice as likely as homeowners in low-income white areas to receive subprime refinance loans when refinancing; and

WHEREAS, over half of mortgage refinancing is in predominately white neighborhoods; and

WHEREAS, studies by Fannie Mae and Freddie Mac suggest that subprime lenders charge prime borrowers who meet conventional underwriting standards higher rates than those for which they qualify; and

WHEREAS, the practice of predatory lending and high cost payday lending are stripping the wealth from these sectors of the populations; and

WHEREAS, these predatory and payday lending practices are deepening debt and stripping equity from these populations; and

WHEREAS, predatory lending strips over $9 billion of wealth annually from
Americans families; and

WHEREAS, the financing of excessive upfront fees strips equity from homes without providing any benefit to borrowers; and

WHEREAS, the practices of "flipping" borrowers through repeated fee-loaded refinancing strips hard-earned equity repeatedly without providing a net tangible benefit for the borrower; and

WHEREAS, responsible lenders in the subprime sector play an important role for providing borrowers, who have encountered temporary credit problems, with a bridge to conventional financing; and

WHEREAS, abusive practices such as prepayment penalties, balloon payments and negative amortization prevent this transition from taking place; and

WHEREAS, payday lenders regularly charge customers making five or more loans per year thus, creating a debt treadmill for borrowers; and

WHEREAS, payday lenders regularly charge customers rates in excess of 500%; and

WHEREAS, ninety (90) percent of total payday loans come from customers taking five or more loans per year, creating a debt treadmill for borrowers; and

WHEREAS, forced arbitration clauses in consumer contracts insulates unfair and deceptive practices from effective review and closes the courtroom door for borrowers who have been wronged; and

WHEREAS, mortgage brokers originate over half of all mortgage loans and a relatively small number of brokers are responsible for a large percentage of predatory loans: such broker practices are largely unregulated; and

WHEREAS, many borrowers are denied justice because a predatory loan has been purchased or assigned to a third party; and

WHEREAS, disclosure, education and protections and remedies under the Federal Home Ownership and Equity Protection Act are important but inadequate responses to the problem of payday and predatory lending.

THEREFORE, BE IT RESOLVED, that the NAACP shall stand against such practices and vigorously seek to prohibit payday and predatory lending. These reforms should address steering borrowers to subprime loans, preventing financing of excessive fees, limiting prepayment penalties, sufficiently addressing mortgage broker abuse and addressing unfair forced arbitration clauses; and

THEREFORE, BE IT FINALLY RESOLVED, that the NAACP shall seek the advanced reforms by financial institutions, regulators and policymakers.

Attachment I: NAACP Action Item passed by the NAACP National Board of Directors, February 2003, New York, NY

ACTION ITEM IN FAVOR OF AGGRESSIVE, EFFECTIVE ANTI-PREDATORY LENDING LEGISLATION

February 15, 2003

WHEREAS the NAACP has strong, established policy against predatory lending; and

WHEREAS numerous studies, including two recent ones by the Center for Community Change and ACORN, clearly demonstrate that predatory lending is especially prevalent in communities of color and that the disparity between whites and African –Americans and other racial and ethnic minorities actually grows at upper-income levels and is greater for higher-income African-American homeowners than for lower-income white homeowners; and

WHEREAS predatory lending is clearly an important civil rights issue; and

WHEREAS predatory lending ruins lives, families and whole communities; and

WHEREAS some states and communities, including California, North Carolina, Georgia, New York City and Oakland, California have enacted strong anti-predatory lending laws; and

WHEREAS the problem of predatory lending has exploded in the last two decades and is continuing to grow; and

WHEREAS there is a clear need for strong federal legislation to address this serious problem.

THEREFORE BE IT RESOLVED that the NAACP calls on Congress to swiftly and without delay enact legislation that expands the Home Ownership and Equity Protection Act ("HOEPA") to all home mortgage lending; and

THEREFORE BE IT FURTHER RESOLVED that the NAACP calls on Congress to reject any proposal that would preempt effective state or local anti-predatory lending laws; and

THEREFORE BE IT FURTHER RESOLVED that the NAACP calls upon Congress to pass legislation to significantly lower the threshold of high cost loans; and

THEREFORE BE IT FURTHER RESOLVED that the NAACP calls on anti-predatory lending legislation that significantly limits or eliminates prepayment penalties; and

THEREFORE BE IT FURTHER RESOLVED that the NAACP calls for the enactment of legislation that places very strict limits on the amount of points and fess financed into a high cost loan; and

THEREFORE BE IT FURTHER RESOLVED that the NAACP calls on Congress to include the expansion of grassroots housing counseling programs in any predatory lending legislation.

Testimony of

DIANA L. TAYLOR

SUPERINTENDENT OF BANKS

For the

STATE OF NEW YORK

on behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

Before the

FINANCIAL SERVICES SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

UNITED STATES HOUSE OF REPRESENTATIVES

January 28, 2004

Good morning Chairwoman Kelly, Congressman Gutierrez and members of the Subcommittee. I am Diana Taylor, Superintendent of Banks for the State of New York and am here today testifying on behalf of the Conference of State Bank Supervisors (CSBS). I thank you for inviting CSBS here today to discuss our concerns about the Comptroller of the Currency's recent preemption of state consumer protection laws and enforcement authority.

CSBS is the professional association of state officials who charter, regulate and supervise the nation's approximately 6,200 state-chartered commercial and savings banks, and more than 400 state-licensed foreign banking offices nationwide.

CSBS brings all of the state bank supervisors together at the national level to coordinate, communicate, advocate and educate on behalf of the state banking system. We commend you on this important and timely hearing, and we especially appreciate this opportunity to represent state banking's views on the interplay of state and federal laws that govern the operation of banks and their subsidiaries.

As you know, the Comptroller of the Currency has recently issued sweeping regulations that seek to preempt almost all state laws that apply to national banks and their subsidiaries. This regulation also tries to shield all national banks – and their subsidiaries – from oversight, inspection and enforcement actions by any state authority, including the state attorneys general.

The Comptroller has said that these new regulations are merely the next natural step in that agency's interpretation of the National Bank Act, the Riegle-Neal Interstate Banking and Branching Efficiency Act, and Gramm-Leach-Bliley.

The Comptroller has also said that these changes are incremental in nature and unlikely to have major effects on the banking industry or on consumers' experiences with financial institutions.

Chairwoman Kelly, members of the Committee, these claims are not true. These regulations are not minor or incremental changes. Their scope is nearly unlimited, and their implications are potentially enormous. These regulations exceed the OCC's statutory authority and disregard Congressional intent. The OCC adopted these regulations over the strong objections of CSBS, the National Governors Association, the National Conference of State Legislatures and all fifty state attorneys general. In adopting the regulations, the OCC ignored your own request for extra time to consider their implications. Instead, the OCC issued a set of regulations that may affect millions of consumers across the country without a public hearing and without meaningful consultation with the parties these regulations would affect.

The states recognize that technology is changing the delivery of financial products and that many large banks and some small banks look less like the old commercial bank and more like the diversified financial services providers envisioned by the Gramm-Leach-Bliley Act's financial modernization. We appreciate that the largest financial services providers want to see more coordinated regulation and want to be able to easily realize their plans to create a nationwide financial marketplace. Their business desires are understandable. However, The Comptroller's stealth plan to cater to their desires is neither easily understandable, nor is it is reasonable.

The OCC's new regulations usurp the powers of the Congress, stifle state efforts to protect their citizens, and threaten not only the dual banking system but also public confidence in our financial services industry. They challenge the

functional regulatory structure created by Gramm-Leach-Bliley and set the Office of the Comptroller of the Currency as the nation's dominant regulator, not only of banks, but of a whole new class of financial institutions.

We salute the Subcommittee for holding this important hearing, and for expressing appropriate concern before this regulation became final. On a personal note, I want to say, Chairwoman Kelly, that you have been a leader on this issue.

As for the impetus of these regulations as they relate to predatory lending, I understand that financial services providers have objected to state laws that have been enacted. I myself have some disagreements with our law in New York as it's currently written. But there is a right way and a wrong way to seek to change the law. The circumvention of the legislative process is not the right way. For an unelected regulator to use the rather technical rulemaking process in an apparent attempt at regulatory empire building, sweeping away the work of thousands of state legislators to protect millions of consumers, is absolutely wrong. And let me be perfectly clear – what the Comptroller has done affects not only predatory lending laws, but all state consumer protection laws and the enforcement of those laws in the states.

If you allow these OCC rules to stand, our banking system and bank customers will be hurt.

As New York Superintendent of Banking I am concerned about New York consumers. Not just those that do business with our state chartered banks. But the New Yorkers who do business with any financial institution that operates in the state. I care so much, in fact, that in order to protect them, I have begun to work with consumer groups, financial institutions and our legislators to draft a bill that we will ask you, Congress, to pass as a national consumer protection law.

And why will I be coming to Congress to ask you to enact a law? Because in order to protect New Yorkers Congressional action will be our only recourse, if the Congress does not act now to block these regulations. If Congress cannot turn these changes aside, the next time you see me I will have this bill in my hand. This is how important this issue is.

And this is the *right* way to change a law – in public, through the democratic process.

However, does Congress want to be responsible for all financial consumer protection issues? Should the only answer be a national standard? CSBS believes that is the dynamic set forth by the OCC's actions.

We urge this Committee and the Congress to reassert their authority in this area. It remains Congress's responsibility to set the policy that bank regulators implement. Congress has already laid out a framework for the interaction of state and federal banking laws; the OCC's regulations would make that framework irrelevant and obsolete. Recognizing the needs of our diverse banking system and its consumers, the Congress should intervene to reaffirm the balance of our dual banking system and reject the OCC's drive to change our system of regulation and applicable law so radically without any Congressional input.

Importance of Decentralized Supervision

Maintaining a local role in consumer protection and a strong state banking system is more important than ever as we see a new round of mergers among our nation's largest financial institutions. These mergers make economic sense for the institutions involved, and may offer the customers of these institutions a larger menu of products and services at prices that reflect economies of scale. But the strength of our banking system is its diversity – the fact that we have enough financial institutions, of enough different sizes and specialties, to meet the needs of the world's most diverse economy. Centralizing authority or financial power in one agency, or in a small group of narrowly-regulated institutions, would threaten the dynamic nature of our economy.

Federal Reserve Chairman Alan Greenspan has said that our "decentralized and diverse banking structure" was arguably the key to weathering the financial crisis of the late 1980s and returning quickly to economic health. Compare the speed of this recovery to the centralized banking system of Japan, which has spent more than a decade in economic malaise as a result of the system's inability to confront its problems and address them.

State supervision and regulation are essential to our decentralized system. State bank examiners are often the first to identify and address economic problems, including cases of consumer abuse. We are the first responders to almost any problem in the financial system, from downturns in local industry or real estate markets to the emergence of scams that prey on senior citizens. We can and do respond to these problems much more quickly than the federal government.

The Comptroller has argued that the laws and rules states have enacted to protect their citizens are burdensome to national banks. We are sensitive to

regulatory burden, and constantly look for ways to simplify and streamline compliance. It is noteworthy, however, that as technology enables the drive to a nationwide financial marketplace, it is also technology that makes compliance with both federal and state laws easier for financial institutions than at any point in our history. Since 2003 was yet another year of record earnings for the entire industry, we cannot see justification for the Comptroller's argument that national banks should be exempt from the laws that apply to any other bank or any other business in a particular state. Where is the evidence that state consumer protection laws are harming the national banking system? Why – through regulatory action – is one class of institutions being shielded from these laws?

Dual Banking System and History of Preemption

The dual banking system is part of our democratic heritage. The phrase "dual banking" refers not only to the parallel systems of state and federal banking regulation, but also to the interaction of state and federal laws for the benefit of our national and local economies. Since the creation of our dual banking system in 1864, all banks, regardless of their charter, have been subject to a combination of federal and state laws. The balance of state and federal authority has evolved, shaped by new state and federal statutes and by a growing body of case law.

In general, the principle that has governed the interaction of state and federal law over national banks is that federal law overrides state law where the two statutes directly conflict, or where the state law significantly impairs the national bank's ability to conduct its federally-authorized business. National banks and their subsidiaries have traditionally been subject to a wide range of state corporate laws, and Congress has consistently deferred to state law in several areas.

Most relevant to the current discussion is Section 24 of the Riegle-Neal Interstate Banking and Branching Efficiency Act, which provided for state law to apply to the interstate branches of national banks in four key areas -- intrastate branching, consumer protection, fair lending and community reinvestment – as long as these laws did not discriminate against national banks on the basis of their charter. This applicable law provision was a key element of the compromise that produced the nationwide branching law. Congress expressed its clear intent, in report language, that states should be able to offer all their citizens equal consumer protections, regardless of whether these citizens used a state or a national bank.

The ten years since the passage of Riegle-Neal have transformed the financial services industry, and in this transformation we have seen the value and strength of our dual banking system. Banks have taken advantage of their new powers under Riegle-Neal and Gramm-Leach-Bliley to offer their customers an unprecedented range of new products and services. Many of these products and services originated at the state level; my own state of New York, for example, brought the industry the ATM and basic banking, as well as the nation's first interstate branching law.

Over the past ten years, however, we have seen a new aspect of the dual banking system's value. As new products and services have emerged, so too have new opportunities for consumer confusion and, in some cases, abuse. The explosion of the mortgage industry created a new class of lenders for nonprime borrowers, and in some cases, these lenders engaged in predatory and fraudulent practices. New York and many other states sought remedies through regulation, legislation, and financial education campaigns. Our efforts have reached thousands of borrowers and potential borrowers, punished and discouraged predatory lenders, and provided a model for action at the federal level.

Our experience in this area shows that the dual banking system is not a museum artifact or an anachronism, but a vital and essential dynamic for promoting new financial services while offering new approaches for consumer protection.

Ten years after the passage of nationwide banking, the dual banking system is more important than ever because it ensures diversity in our financial services system, and it ensures that the regulatory system addresses local concerns as well as national concerns. In this case, that specifically means the interests of local borrowers and consumers.

The traditional dynamic of the dual banking system has been that the states experiment with new products and services that Congress later enacts on a nationwide basis. We generally discuss this history in terms of expanded powers, but the states have been innovators in the area of consumer protection, as well. States enacted CRA and fair lending statutes before the federal government did, and states are now leading the way on predatory lending, identity theft, and privacy initiatives. These state laws, which the OCC sees as burdensome to national banks, are in fact providing all of us the opportunity to see what works and what doesn't, and find the appropriate balance before seeking legislation on a national level.

CSBS does suggest, however, that there is a new dynamic in our dual system of applicable state and federal law for financial institutions, and that is the activism of city and local governments in setting the terms of lending in response to concerns over predatory lending practices. The federalism dynamic of our banking system might be enhanced by clarifying that laws governing lending are limited to state and federal laws – not city and local -- as has been the response of many state legislatures.

While it has been served up as the poster child for OCC preemption, the Georgia predatory lending statute is, in fact, a good example of how responsive the state system can be. Seeing a need for additional consumer protections, the Georgia state legislature approved a law that took effect on October 1, 2002. Problems with this statute surfaced almost immediately. Both the financial services industry and the regulators involved went back to the legislature to seek a remedy, and the legislature passed revisions to that law on March 10, 2003 – less than six months later.

The OCC is attempting to short-circuit this dynamic with the sweeping *de facto* "field preemption" of these recent regulations. States may continue to seek new ways to protect their citizens, but if the OCC's regulations were to be upheld, these efforts would be ineffectual, because the laws would not apply to the customers of most of the nation's largest financial institutions who increasingly control much of the nation's financial assets. As I said earlier in my testimony, new consumer protection laws governing these institutions would have to originate at the federal level. As you know, enacting federal legislation is a long and cumbersome process, and federal laws necessarily address problems with broad strokes that may not be appropriate for both large and small organizations within the same industry. The state system is much better equipped to respond quickly, and to tailor solutions to the specific needs of various communities and industry sectors. If you lose the states as a laboratory for consumer protections and other innovations you lose a great attribute of our federalist system – the ability to find out what does and doesn't work. And also the ability to tailor the response to the problem – Wyoming doesn't necessarily need the solution for the problems we've identified in New York.

Preemption, as the Comptroller has noted, has always been part of the dynamic of our dual banking system. Congressional preemption may be necessary at times to create uniform national standards, as with the recently-enacted Fair and Accurate Credit Transactions Act. The Conference of State Bank Supervisors supported congressional preemption in this case. But we strongly oppose broad OCC regulatory preemption in the absence of express guidance from Congress or meaningful consultation with the states.

Riegle-Neal, in fact, lays out a process of notice and consultation for the preemption of state laws, and does not contemplate the kind of *de facto* "field preemption" embodied in these new OCC regulations. This process is rooted in our democratic tradition, ensuring accountability, while allowing action when necessary. The Comptroller of the Currency has justified his recent actions by saying that they will improve the operating efficiency of national banks; is this purported operating efficiency worth discarding our democratic process?

A New Class of Unregulated Institutions

Congress created a structure for functional regulation and consistently expressed concern about consumer protection when it passed Gramm-Leach-Bliley in 1999. At the time, that structure did not contemplate the creation of a class of businesses that would not be subject to ordinary state consumer protection laws. But the Comptroller is attempting to do that through these regulations.

This is an issue that transcends banking, and in some cases transcends our traditional view of financial services. With these regulations, the Comptroller seeks to exempt an entire spectrum of mortgage banks and mortgage brokers, finance companies, title companies, leasing companies, and retail securities brokerages from local laws -- *if* these companies are lucky enough to be

subsidiaries of a national bank. Madam Chairman, this is not the action of a responsible regulator.

In New York, the OCC has pushed aside our more specific definition of predatory lending for a narrower, more vague standard.

The OCC defines a predatory loan as one that is made with the lender's knowledge that the borrower cannot afford the loan at the time it is made.

Our definition of predatory lending is when one or more of three events occur: first, a loan is made that is not affordable for the borrower; second, the fees and other charges imposed on the borrower have no reasonable relationship to the risk involved or the cost of services rendered by the lender in making the loan; or third, the loan has no apparent benefit to the borrower.

These three standards are straightforward. They do not require murky or subjective supervisory judgments.

What about single premium credit insurance? When financed, this is one of the most abusive products ever devised. It exists only to protect the lenders' stream of interest payments.

And what about flipping, where the borrower ends up with less and less equity until foreclosure looms? The OCC does not include either of these practices in its definition of predatory lending, but rather merely mentions them in its guidance saying that such practices *may* be abusive.

The OCC has said that it will provide the necessary oversight and enforcement to address consumer concerns. We believe that the OCC means what it says, but we question whether the agency has the resources to take on these new responsibilities. Nor has the OCC announced any plans to add the staff necessary

to deal with the increased volume of consumer complaints it will receive. On the contrary, we have seen the OCC intervene time and time again on behalf of the nation's largest banks to prevent the implementation of state consumer protection laws. In these cases, the OCC has not been the consumer's advocate.

The OCC's preemption would create an uneven playing field for national banks and state chartered banks, and that concerns us. What concerns us even more, however, is that this preemption would also create an uneven playing field for consumers. Borrowers who walk into a mortgage lender, a money transmitter office or a payday lender don't know whether that business is owned by a national bank. Those borrowers have the reasonable expectation that state laws will protect them. If borrowers need to seek remedies, their first instinct will not be to complain to the OCC. More often than not, they will come to us – to the state banking departments and consumer credit agencies.

We will have to refer them to the OCC's consumer compliance center in Houston, Texas, knowing that the OCC may well tell these customers that they do not have the legal remedies that state laws have tried to give them.

This is not a far-fetched scenario. This is what happened in 2000, when customers of FleetBoston complained to the OCC about deceptive credit card marketing practices. These practices – raising interest rates after promising a "fixed" rate – were illegal under Rhode Island state law. The OCC wrote back to these customers saying that FleetBoston had not violated federal law, and that customers should seek remedies through their own legal counsel. But when customers sought to file a class action lawsuit against FleetBoston for violation of Rhode Island's laws, the OCC intervened with a friend-of-the-court brief in support of FleetBoston. In this case, at least, the OCC was not focused on helping consumers.

And still the OCC contends that national banks and their operating subsidiaries do not engage in abusive and predatory practices.

I beg to differ. These examples are specific to New York State.

First, the story of Mrs. N. She is 72 years old, and has lived in her Elmhurst, Queens home for more than 30 years. An unscrupulous broker solicited her for a refinance in October 2001 because she had a $2,200 tax lien on her property.

The broker told Mrs. N. that she would be able to get an affordable refinance that would reduce her existing interest rate of 9 percent. She ended up with a $105,000 loan from an operating subsidiary of a Midwest-based national bank that raised her interest rate to 10.5 percent and her monthly payment by nearly $200. Even worse, because her new loan is an Adjustable Rate Mortgage, her interest rate could grow to as high as 16.375 percent.

Mrs. N.'s new monthly payments comprise 67 percent of her monthly income from Social Security and pension. Her sole benefit from the refinance was the payoff of the tax lien, which she could have satisfied with direct payments to the New York City Department of Finance through an affordable payment plan.

Instead, the refinance cost her nearly $11,000 in closing costs (including more than $4,000 in fees), increased her monthly payments to an unaffordable level, and put her at risk of foreclosure.

Mrs. N is now in default on the loan and is working with South Brooklyn Legal Services toward a solution.

The lender violated New York State's Deceptive Practices Act and New York State's anti-predatory lending regulation. If the OCC's preemption stands, the state could do nothing but refer Mrs. N. to the OCC's call center.

The OCC would counter that this is the sort of problem they could – as their spokesperson averred in a recent news story – "solve in an hour." But it is not clear that this transaction would even be a predatory loan under the OCC's new standards.

And in case you believe that banks would not dare engage in these practices through operating subsidiaries, I have another story for you. The case of Mr. M. is one of the most egregious I have ever seen. Mr. M. is 68 years old and had lived with his wife and daughter in East New York, Brooklyn for more than 20 years. In 1999, he was forced to retire from his job at the postal service, where he had worked for more than 25 years. With his income cut in half, he quickly fell two months behind on his mortgage. Desperate, he contacted an operating subsidiary of a nationally-chartered bank about the refinance, on the referral of a lawyer. Mr. M. was sent to what he believed were their offices in Long Island to arrange the loan.

The op-sub wanted to refinance his $98,000 mortgage balance into a $135,000 loan, which increased his monthly payments by more than $500. They urged him to refinance his credit card debt into the new mortgage, telling him that it would decrease his monthly debt. As he was concerned about the credit card debt that had been mounting since he had lost his job, he agreed. He did not understand, nor was it explained, that because he was refinancing unsecured debt with an unaffordable, secured debt, the refinancing of his credit card debt would put him at risk of losing his home.

Although Mr. M. contacted the op-sub directly and did not even know that a mortgage broker was involved, the loan included both an $8,100 broker's fee and a $1,350 yield spread premium.

Mr. and Mrs. M.'s joint monthly income at the time of the loan was only about $1,800. The lender made them a loan with monthly payments of $1,367, not including taxes and insurance. When Mr. M. expressed concern about the amount of the monthly payments, he was told that he could refinance at a lower rate if he made his payments for a year. He agreed to the loan because he was desperate about his mounting debt and afraid of losing his home, and because he hoped that he could secure another job to help pay the mortgage.

He later learned that the op-sub's loan file contained an unverified falsified lease for $900 a month with the name of a nonexistent tenant. When a forensic document examiner later evaluated the lease, this examiner found that Mr. M's signature had been forged.

Failure to verify income is illegal in New York.

What protections would the Ms have under the new OCC rules? I don't know that anyone can say at this point.

Certainly they could call the OCC's compliance hotline in Houston. Maybe their problem could be solved in an hour, too.

We are resolving some of these cases, and I can tell you that they take considerably longer than an hour. In a case we have recently resolved, the mortgage affiliate of a large national bank has been made to recast and/or make

refunds on 1,372 loans due to violations of New York's predatory lending regulations. Consumers received refunds of nearly $700,000.

The debt-to-income ratio on 205 of these loans exceeded 50 percent, with no evidence that the borrowers had the capacity to repay these loans at the time they were made, nor any compelling reasons that would have justified these loans. It appears that the banker was relying on future increases in the value of the collateral for repayment.

This is illegal in New York.

The rest of the loans were found to have included points and fees that exceeded New York's predatory lending threshold. The banker had incorrectly excluded appraisal and title fees paid to an affiliate from the compliance calculation.

This is illegal in New York.

The banker had also been excluding renewal loans, where no additional funds were disbursed, from the anti-predatory lending compliance requirements.

This is illegal in New York.

In determining the borrower's ability to repay, the banker was excluding premiums for membership in protection plans.

This is illegal in New York.

We also found instances where the lender sold consumers products for which they did not qualify, such as disability insurance to unemployed borrowers and to borrowers on active duty military service.

This is illegal in New York.

We were able to take legal action against this business because it was an affiliate of a national bank, not an operating subsidiary. Under the Comptroller's new regulations, we would not have been able to take these actions – or win those consumer refunds – if this business were an operating subsidiary. It is not unreasonable to expect that bank holding companies, understanding this, would convert affiliates to operating subsidiaries in an effort to escape our laws.

The OCC has already challenged individual states' efforts to enforce consumer protection laws over car dealerships, telemarketers, an unlicensed trade school and an air conditioning company because all of these businesses had financing relationships with national banks. It boggles the mind to think that we have seen the OCC defend national banks' right to partner with organizations that violate state law, but this is exactly what is happening – and this, on a grand scale, would be the immediate result of the Comptroller's new preemption regulations. These regulations would effectively allow national banks to profit by "renting" their preemption authority to agency relationships.

We believe that these regulations far exceed the Comptroller's statutory authority under the National Bank Act, which generally allows preemption only when state laws significantly interfere with a national *bank*'s ability to exercise the powers of its charter. Before Gramm-Leach-Bliley, we were used to thinking of the activities of bank subsidiaries as an extension of the bank itself. Now, however, the activities of a bank's subsidiary may be so far removed from the

bank that the consumer would never make the mental connection between that business and the parent bank. State regulation and oversight of these businesses, which often required separate licenses, filled any oversight gap and made sure that consumers had a local contact for complaints.

And the state mechanism for responding to consumer complaints - many related to the subsidiaries and affiliates of national banks -- has been working, with millions, even hundreds of millions of dollars being returned to mistreated consumers. After an historic 2002 settlement with a single institution, the states returned more than 500 million dollars to consumers who had been victimized by fraudulent or deceptive trade practices in 2002 alone.

States handle financial consumer complaints not only through our banking departments, but also, in many cases, through separate departments that address nonbanking consumer credit issues. The states already have networks in place for referring complaints to the appropriate agencies, and to law enforcement authorities when necessary. The states dedicate hundreds of employees to handling these consumer complaints, and these resources strain to keep up with the demand.

The Comptroller's regulations displace this network for national banks and their subsidiaries. The Comptroller's new regulation would also prevent state law enforcement authorities from intervening in potentially fraudulent or deceptive activities of businesses that happened to be owned by a national bank.

What is the justification for displacing existing resources -- for pushing aside the local cop on the beat? With limited resources at both state and federal levels, we should be talking about sharing responsibilities, not preempting valuable resources.

Conclusion

For more than 150 years, Congress has been careful to balance the interests of local government with the interests of a nationwide banking system. In enacting new banking laws, Congress has consistently paid deference to state laws in general and state consumer protection laws in particular. Riegle-Neal stipulated that state laws on intrastate branching, community reinvestment, fair lending and consumer protection would continue to apply to the branches of national banks, *unless* these laws discriminated against national banks or were specifically preempted by federal law.

The Comptroller's proposed regulations have the opposite effect, with the perverse result that state consumer protection laws would discriminate against state-chartered financial institutions. In some states, we may see legislatures move to reduce these consumer protection laws to avoid this discriminatory treatment. This is not in the public interest. Surely it was not Congress's intent.

This debate should not be about protecting or advancing one charter over another. It should not be about turf. It should be about creating the best structure for a financial services system that allows a wide range of financial institutions to compete effectively and make their products and services available to all segments of our nation, and that offers consumers protection and remedies against fraudulent and misleading practices – no matter the charter of the consumers' financial institution. If Congress finds that federal preemption is necessary to achieve this goal, we will accept that. With his actions, however, the Comptroller of the Currency is trying to cut off this discussion altogether.

The Conference of State Bank Supervisors supports nationwide banking. We support interstate operations and the ability of customers to be able to move and travel with their financial institutions, and we have worked hard to create a structure that facilitates interstate branching. We support competition in the marketplace and meaningful customer choice. We constantly seek opportunities to decrease regulatory burden and help our largest financial institutions develop more efficient operating systems. But this efficiency cannot come at the expense of the consumer, or at a competitive disadvantage to the thousands of community-based institutions that serve these consumers. Our highly diverse financial system is the envy of the world. The lesson that much of the world has never learned is that the flexibility and responsiveness of the U.S. financial markets and financial regulators are the result of our decentralized regulatory system. CSBS believes that the OCC's *de facto* "field preemption" is a dangerous move toward centralization that could rob our dual banking system of one of its greatest attributes.

We urge Congress to look carefully at this regulation and its implications, and consider whatever actions may be necessary to clarify the interaction of state and federal laws, restore the balance of the dual banking system, and reassert its authority over federal banking policy.

Ultimately, you must decide whether you are comfortable putting your constituents in the hands of an unelected official who, with the stroke of a pen, seeks to sweep aside all state consumer protection laws, and has effectively declared all national banks and their operating subsidiaries in your state exempt from the authority of your Governor, your state's Attorney General, your state legislature and your state's financial regulators.

The Conference of State Bank Supervisors wants to be part of the solution. We look forward to working with the Congress and with the federal banking agencies to build a structure that facilitates nationwide banking without harming our economies or the consumers our institutions serve.

Thank you for your attention. I look forward to answering the Committee's questions.

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Remarks by John Taylor, President and CEO of the
National Community Reinvestment Coalition before the
U.S. House of Representatives
Financial Services Committee, Oversight and Investigations Subcommittee

Congressional Review of OCC Preemption: The Impact on Housing and Community Development

Introduction

Good morning Representatives Kelly and Gutierrez and distinguished Members of the Committee. My name is John Taylor and I am the President and CEO of the National Community Reinvestment Coalition in Washington, D.C. I would like to thank you for the opportunity to speak to you today regarding the OCC's preemption of state anti-predatory lending law.

Background

NCRC is a national trade association representing more than 600 community-based organizations and local public agencies who work daily to promote economic justice and increase fair and equal access to credit, capital and banking services to traditionally underserved populations in both urban and rural areas.

NCRC supports long-term solutions that provide resources, knowledge, and skills to build community and individual wealth. NCRC has represented our nation's communities on the Federal Reserve Board's Consumer Advisory Council, Community Development Financial Institutions Advisory Board, Freddie Mac's Housing Advisory Council, Fannie Mae's Housing Impact Council and before the United States Congress.

NCRC works directly with the community through our services including the Consumer Rescue Fund, and Financial Education and Outreach initiatives. Our Consumer Rescue Fund initiative has assisted more than 500 consumers who were victims of predatory lending. We also provide financial education to help low- and moderate-income people achieve homeownership and access to wealth.

Predatory Lending and Discrimination

Predatory lending has surged in recent years. Now, more than ever, we need strong and comprehensive anti-predatory laws at the state and federal level. We need more consumer protections, not less. Yet the OCC has just boldly preempted state anti-predatory law.

NCRC recently issued a report we called the *Broken Credit System* (available via http://www.ncrc.org). We find that African-American and elderly communities receive a considerably higher level of high cost loans than is justified based on the credit risk of neighborhood residents.[1] President Bush has declared an Administration's goal of 5.5 million new minority homeowners by the end of the decade. The widespread evidence of price discrimination threatens the possibility of creating sustainable and affordable homeownership opportunities for residents of traditionally underserved neighborhoods.[2]

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[1] NCRC used 2001 HMDA data and 1999 data on creditworthiness obtained from one of the three major credit bureaus. For more information about the report's methodology, please visit our web site, http://www.ncrc.org.

[2] A subprime loan has an interest rate higher than prevailing and competitive rates in order to compensate for the added risk of lending to a borrower with impaired credit. NCRC defines a predatory loan as an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers. Predatory loans are a subset of subprime loans. A predatory loan has one or more of the following features: 1) charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections, 2) contains abusive terms and conditions that trap borrowers and lead to increased indebtedness, 3) does not take into account the borrower's ability to repay the loan, and 4) violates fair lending laws by targeting women, minorities and communities of color. Using the best available industry data on credit worthiness, NCRC uncovered a substantial amount of predatory lending involving rampant pricing discrimination and the targeting of minority and elderly communities.

Sadly, it is still the case in America that the lending marketplace is a dual marketplace, segmented by race and age. If a consumer lives in a predominantly minority community, he or she is much more likely to receive a high cost and discriminatory loan than a similarly qualified borrower in a white community. At the same time, the elderly, who have often built up substantial amounts of equity and wealth in their homes, are much more likely to receive a high cost refinance loan than a similarly qualified younger borrower. The disproportionate amount of subprime refinance lending in elderly neighborhoods imperils the stability of long-term wealth in communities and the possibilities of the elderly passing their wealth to the next generation.

Lending discrimination in the form of steering high cost loans to minorities and elderly borrowers qualified for market rate loans results in equity stripping and has contributed to inequalities in wealth. According to the Federal Reserve Survey of Consumer Finances, the median value of financial assets was $38,500 for whites, but only $7,200 for minorities in 2001. Whites have more than five times the dollar amount of financial assets than minorities. Likewise the median home value for whites was $130,000 and only $92,000 for minorities in 2001.[3]

NCRC selected ten large metropolitan areas for our analysis: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington DC. As expected, the amount of subprime loans increased as the amount of neighborhood residents in higher credit risk categories increased. After controlling for risk and housing market conditions, however, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending.

For example:

[3] Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, Federal Reserve Bulletin, January 2003.

- The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas.

- The percent of African-Americans in a census tract had the strongest impact on subprime refinance lending in Houston, Milwaukee, and Detroit. Even after holding income, creditworthiness, and housing market factors constant, going from an all white to an all African-American neighborhood (100 percent of the census tract residents are African-American) increased the portion of subprime loans by 41 percentage points in Houston.

- Solely because the percentage of the African-American population increased, the amount of subprime home purchase lending surged in Cleveland, Milwaukee, and Detroit. From an all white to an all African-American neighborhood in Cleveland, the portion of subprime home purchase loans climbed 24 percentage points.

- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.

- Elderly neighborhoods experienced the greatest increases in subprime refinance lending in St. Louis, Atlanta, and Houston. Even after holding income, creditworthiness, and housing market factors constant, the portion of subprime refinance lending would surge 31 percentage points in St. Louis from a neighborhood with none of its residents over 65 to all of its residents over 65.

NCRC's findings are consistent with a body of research on subprime lending. A recent survey study conducted by Freddie Mac analysts finds that two-thirds of subprime borrowers were not satisfied with their loans, while three-quarters of prime borrowers

believed they received fair rates and terms.[4] In previous years, Freddie Mac and Fannie Mae have often been quoted as stating that about a third to a half of borrowers who receive subprime loans actually qualify for lower cost loans.[5] Dan Immergluck, a professor at Grand Valley State University, was one of the first researchers to document the "hypersegmentation" of lending by race of neighborhood.[6] Like Immergluck's work, the Department of Housing and Urban Development found that after controlling for housing stock characteristics and the income level of the census tract, subprime lending increases as the minority level of the tract increases.[7] The Research Institute for Housing America, an offshoot of the Mortgage Bankers Association, released a controversial study in 2000 that concluded that minorities were more likely to receive loans from subprime institutions, even after controlling for the creditworthiness of the borrowers.[8]

NCRC's study is quite similar and builds upon important research conducted by a Federal Reserve economist and two researchers from the Wharton School at the University of Pennsylvania. Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School also use credit scoring data to conduct econometric analysis scrutinizing the influence of credit scores, demographic characteristics, and economic conditions on the level of subprime lending. Their study found that after controlling for creditworthiness and housing market conditions, the level of subprime refinance and home purchase loans increased in a statistically significant fashion as the portion of African-Americans increased on a census tract level in Philadelphia and Chicago.[9]

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[4] Freddie Mac analysts Marsha J. Courchane, Brian J. Surette, Peter M. Zorn, *Subprime Borrowers: Mortgage Transitions and Outcomes*, September 2002, prepared for Credit Research Center, Subprime Lending Symposium in McLean, VA.
[5] "Fannie Mae Vows More Minority Lending," in the Washington Post, March 16, 2000, page E01. Freddie Mac web page, http://www.freddiemac.com/corporate/reports/moseley/chap5.htm.
[6] Dan Immergluck, *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development*, the Woodstock Institute, November 1999.
[7] Randall M. Scheessele, *Black and White Disparities in Subprime Mortgage Refinance Lending*, April 2002, published by the Office of Policy Development and Research, the U.S. Department of Housing and Urban Development.
[8] Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why*? Working Paper No. 00-03, published by the Research Institute for Housing America, September 2000.
[9] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov.

Equity Stripping and Foreclosure

While price discrimination is insidious, it is often combined with abusive terms and conditions that compound the evils of predatory lending. Overpriced loans with abusive terms and conditions strip equity out of borrowers' homes and often lead to foreclosure. Major abuses associated with predatory lending include packing loans with usurious fees and unnecessary products, steep prepayment penalties, repeated refinancing or flipping, single premium credit insurance, and mandatory arbitration.

The abusive terms and conditions on predatory loans can be so harmful that after several years of paying on time, the borrower still owes almost the entire principal on the loan. This is systematic equity stripping. NCRC's Consumer Rescue Fund initiative has uncovered numerous examples of predatory lending in its purest and most vicious form.

NCRC developed the Consumer Rescue Fund (CRF) initiative, designed to get borrowers out of abusive loans and helps borrowers at risk of foreclosure get a fresh start. Under the CRF initiative, NCRC arranges affordable refinance loans for victims of predatory lenders. All CRF loans are conventional home mortgage loans with prime-like interest rates, no fees, no points, no prepayment penalties, and no insurance or ancillary product sales or offerings. The CRF initiative has also created a national predatory lending referral network in cooperation with other consumer rights groups, legal service organizations, and the pro-bono Bar. The purpose of the collaboration is to maximize our collective ability to bring fair lending cases and complaints for matters that were previously perceived as consumer issues.

The following are examples from our CRF Initiative of predatory lending:

- NCRC recently represented an elderly minority couple who had owned their home in the District of Columbia for nearly 40 years. In order to pay medical expenses, a predatory lender convinced the couple to take out an adjustable rate mortgage with a prepayment penalty of over $13,000 and a loan payment that exceeded the couple's

monthly income. Faced with imminent foreclosure, the couple attempted a "short sale" of their home, but was almost unable to complete the sale due to the prepayment provision. After NCRC's intervention, the sale took place.

- NCRC intervened in the case of a borrower saddled with an 11% interest rate home purchase loan. Although the usurious loan had settlement charges of 15 percent, it still had no escrow for taxes and insurance. NCRC staff estimated that the property's appraisal was inflated by about $ 20,000. When the borrower tried to obtain the original appraisal from the lender, he was told it was deleted from the computer. The borrower was also hurried through the closing; he did not understand the loan terms and he did not understand why the closing costs were significantly different from the Good Faith Estimate (GFE). A prepayment penalty equal to six months of interest payments was applied for a period of three years after loan origination.

- NCRC aided a borrower with a balloon loan that had an APR of 11.16 percent. The borrower spoke only Spanish, but the broker conducted the closing in English. Needless to say, the broker did not explain loan terms adequately. When the borrower approached our CRF program, the monthly housing payment to income ratio was an incredible 86 percent. Despite consuming almost her entire monthly income, the loan did not contain an escrow for taxes and insurance payments.

- NCRC's CRF initiative assisted a borrower who originally obtained a home improvement loan. Different lenders convinced the borrower to refinance his loan twice within six months. One lender charged more than $5,600 in fees. After the second flip, the borrower was paying almost 60 percent of his monthly income on mortgage payments

- NCRC assisted a borrower with a balloon loan over $41,000 that had an APR of more than 13 percent. When the balloon payment must be made at the end of 15 years, the borrower will owe $35,000, or almost the entire loan amount.

- NCRC rescued a borrower that had an adjustable rate mortgage of $105,000 with an initial APR of 13.99 percent. The fees and points on this loan amounted to 4.7 percent of the loan amount, due in large part to a broker fee of $4,725. The loan was unaffordable from inception since the broker exaggerated the borrower income by adding the income of a minor, teenage daughter who had worked part time. At time of CRF intake, the total debt to monthly income was an incredible 67 percent. Yet, the loan did not have an escrow for taxes or insurance payments. To escape this predatory loan, the borrower confronted a prepayment penalty of 5 percent for a period of three years after loan origination. Consequently, the foreclosure process had commenced by time the borrower had contacted NCRC.

Predatory Lending Destroys Housing and Community Development

Predatory lending destroys housing and community development in minority and low- and moderate-income neighborhoods across America. When predatory lenders besiege a neighborhood, the initial impact is a reduction in economic activity. Receiving discriminatory and over-priced loans, families lose equity and confront unaffordable mortgage payments. They spend less on products and services. Local businesses lose customers and revenues. After a while, the process is accelerated as more and more neighborhood residents reduce expenditures and businesses stop paying their landlords. Still later, when families lose their homes to foreclosure, property values plummet, houses become abandoned, businesses close, and people move out of the neighborhood. The only party benefiting from this economic devastation is the predatory lender, who profits by sucking wealth from the neighborhood.

It may be tempting to assert that NCRC exaggerates the impact of predatory lending on neighborhoods. But consider that in one Consumer Rescue Fund case, NCRC represented 400 families from an entire neighborhood that had been victimized by predatory developers, appraisers, brokers and lenders. Also consider that lawsuits such as the New York Attorney General's lawsuit against Delta Funding are based on lenders

targeting entire neighborhoods with high levels of minority residents and/or the greatest number of people without high school educations.[10]

The cruel irony is that the Community Reinvestment Act (CRA) and community group activism over the last several years motivated traditional lenders to make more prime and affordable mortgage loans to minority and low- and moderate-income communities. Federal Reserve economists, using NCRC's database on CRA agreements, document that traditional banks make more loans in communities in which they have established partnerships with community groups and negotiated CRA commitments with them.[11] Now, however, all of this noble work is threatened by the surge in predatory lending.

The OCC Anti-Predatory Standard Will Not Protect Communities

The cruel irony is compounded when one of the federal agencies charged with enforcing CRA preempts all state anti-predatory law with one grand stroke of its pen. States lose their ability to protect their citizens from massive foreclosures and loss of wealth.

The OCC boasts that it enacted the strongest regulation ever against predatory lending. In fact, the OCC preempts comprehensive state anti-predatory law with an inadequate regulation. The OCC's regulation states that a national bank shall not make a loan based "predominantly on the foreclosure value of the borrower's collateral, without regard to the borrower's repayment ability." The rule further prohibits national banks from engaging in practices that are unfair and deceptive under the FTC (Federal Trade Commission) Act.

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[10] Complaint by New York State Attorney General against Delta Funding, in the United States District Court Eastern District of New York, August 19, 1999.

[11] *Do CRA Agreements Influence Lending Patterns*? Paper presented at Federal Reserve Community Development conference by Raphael W. Bostic (Board of Governors of the Federal Reserve System and University of Southern California bostic@usc.edu), and Breck L. Robinson (University of Delaware robinsob@be.udel.edu).

The OCC's asset-based standard falls short because it will not cover many instances of predatory lending. For example, an abusive loan can escape OCC scrutiny because it can still strip equity without leading to delinquency or foreclosure. In other words, a borrower can have the necessary income to afford monthly payments, but he or she is still losing wealth as a result of a lender's excessive fees or unnecessary products.

Unlike state law, the OCC regulation does not explicitly prohibit numerous abuses such as flipping, single premium credit insurance, steep prepayment penalties, fee packing, high balloon payments, and mandatory arbitration. The OCC claims that the FTC Act can cover some of these abuses, but many other predatory practices are not addressed by the FTC Act or the OCC's interpretation of the FTC Act.[12]

The OCC's new regulation does not begin to compensate for the roll back in state protections. State law is much more comprehensive and specific than the OCC regulation in its prohibitions against abusive lending, and is thus a much more rigorous legal tool in lawsuits and other enforcement actions. Under state law, state agencies and private citizens were able to sue predatory lenders using a national charter. Now, under OCC preemption, they cannot. It is true that the OCC has used the FTC Act to stop a few national banks in their predatory tracks. But it is unconsciousable to handcuff the ability of states and their citizens to go after the predators using strong state laws.

State Anti-Predatory Lending Laws Combat Abusive Practices Without Decreasing the Availability of Credit

The benefits of state anti-predatory law are clear: prevention of widespread foreclosures, wealth stripping and the preservation of housing and community development. The costs

[12] The OCC issued an Advisory Letter (AL 2003-2) in February of 2003 in which they discuss how the FTC Act could be applied to abusive lending practices. The agency's discussion of applying the FTC Act includes only three abusive practices – flipping, equity stripping, and fee packing. Furthermore, the OCC says that these practices may or may not violate the FTC Act, depending on the "totality of the circumstances" associated with the loan. This Advisory Letter suggests that the OCC's enforcement of its new standard is likely to be more tentative and hesitant than state Attorney Generals and bank commissioners using state law that is much more specific and detailed about how and when abusive practices are illegal.

of state laws are undocumented and illusory. The financial industry claims that state anti-predatory laws increase lending costs and thus causes them to curtail responsible subprime lending. The OCC agrees with these assertions.

In a speech over the summer, Comptroller Hawke said that state anti-predatory laws have "overbroad and unintended adverse effects...effects that, as we've seen, can be almost as harmful as the problem those laws were designed to address."[13]

But the studies to date present inconclusive and contradictory evidence about the possibilities of anti-predatory laws restricting access to credit. On the other hand, the damage caused by predatory lenders is real and severe.

In a paper entitled "Do Predatory Lending Laws Influence Mortgage Lending," Peter Nigro of the OCC and Keith Harvey of Boise State University conclude that North Carolina's anti-predatory law did not affect the subprime market share of loans made to low- and moderate-income borrowers in North Carolina relative to five other Southeastern states. While the authors find a small decrease in the subprime market share to minorities, the change is "significant at the 10 percent level only." In other words, the change for minorities is barely statistically significant. Moreover, Nigro and Harvey find that non-bank mortgage companies decreased their lending to a much greater extent than banks after passage of North Carolina law. This study suggests that national banks have not faced significant constraints nor has their lending been "materially" impacted by passage of state anti-predatory law.[14]

In a more recent study, Professor Michael Stegman and his colleagues at the University of North Carolina concluded that the North Carolina anti-predatory law did not restrict overall access to credit, but did decrease loans with abusive features such as loans with

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[13] Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the Federalist Society, Washington DC, July 24, 2003.
[14] Keith D. Harvey, Boise State University, and Peter J. Nigro, OCC, *Do Predatory Lending Laws Influence Mortgage Lending? An Analysis of the North Carolina Predatory Lending Law*, September 2002, see pg. 14 and 25

prepayment penalties beyond three years.[15] Ironically, the OCC misinterpreted Stegman's work when the OCC asserted a sharp decline in loans in the wake of North Carolina law. The trade publication, *Inside B& C Lending*, reports that the OCC later issued a clarification acknowledging its mischaracterization of the Stegman study.[16]

NCRC is aware that other studies come to opposite conclusions regarding the impact of anti-predatory laws. Professor Staten of Georgetown University asserts that anti-predatory law reduces the number of subprime loans to traditionally underserved borrowers.[17] Nigro and Harvey conducted another study documenting declines in subprime lending after enactment of anti-predatory law by the cities of Philadelphia and Chicago.[18] These studies, however, suffer significant data and interpretative shortcomings. Staten's study relies on data supplied by a trade association of subprime lenders. Nigro's and Harvey's study does not adequately consider that lenders stopped lending in the two cities for a very short time period in order to pressure the cities and their state governments to nullify the laws.

Regardless of whose studies are viewed with more credibility, it is beyond doubt that an impartial observer would conclude that the current level of academic research does not support the bold assertions and actions of the OCC. For each study that asserts impairment of national bank lending, another study discounts that possibility. Moreover, only one study, Stegman's, examines the types of loans affected by anti-predatory law.

Finally, the OCC stretches the bounds of credulity by asserting that state anti-predatory law interferes with the safe and sound operations of banks. In their Question and Answer

[15] Roberto G. Quercia, Michael A. Stegman, and Walter R. Davis, *The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment*, June 25, 2003, the Center for Community Capitalism, University of North Carolina at Chapel Hill.

[16] "OCC Admits NC Slip-Up, but Did Anyone Notice," Inside B&C Lending, August 18, 2003.

[17] Gregory Elliehausen and Michael Staten, *Regulation of Subprime Mortgage Products: An Analysis of North Carolina's Predatory Lending Law*, October 2002, McDonough School of Business, Georgetown University.

[18] Keith D. Harvey and Peter J. Nigro, *How Do Predatory Lending Laws Influence Mortgage Lending in Urban Areas? A Tale of Two Cities*, March 2002.

document on their preemption order, the OCC states, "When national banks are unable to operate under uniform, consistent and predictable standards, their business suffers, which negatively impacts their safety and soundness."[19]

Anti-predatory law prohibits abusive practices, not the provision of basic banking products. Moreover, anti-predatory law is not any more interruptive of uniform national standards than state law applying to many other aspects of banking and lending. Federal statutes including the Real Estate Settlement Procedures Act (RESPA) and the Home Ownership and Equity Protection Act (HOEPA) allow stronger state consumer protection laws to co-exist with federal laws. Lenders have adapted to this regime for decades.

It is predatory lending, not the multiplicity of state law that threatens safety and soundness. Indeed, the FDIC has found that although subprime lenders constitute about 1 percent of all insured financial institutions, they account for 20 percent of depository institutions that have safety and soundness problems.[20] The spectacular failures of Superior Bank and Conseco are testimony that predatory lending devastates financial institutions as well as their borrowers. State anti-predatory law helps lenders save themselves from their own abusive practices instead of presenting a barrier to mainstream lending.

Preemption of State Law Results in Too Few Consumer Protections and Regulators

Any prudent lawmaker would agree that it is dangerous to designate just one agency as the enforcer of consumer protection law in an industry as large and complex as banking. Yet, the OCC's aggressive preemption has done just that. It has replaced anti-predatory law and enforcement in about half of the states with only one federal regulator.[21]

[19] OCC January 7, 2004 press release and accompanying documents, see http://www.occ.treas.gov.
[20] Department of Treasury, Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, Proposed Agency Information Collection Activities (Collecting subprime lending information on call reports), Federal Register, May 31, 2000, pages 34801-34819.

[21] States with anti-predatory laws include AR, CA, CO, CT, District of Columbia, FL, GA, KY, IL, MD, ME, MN, NE, NC, NJ, NM, NY, OH, PA, SC, TX, VA, WV

Using CRA Wiz software produced by PCI Services, Inc., NCRC calculates that OCC-regulated institutions made 4,479,087 single-family loans or about 28 percent of all single family loans reported under HMDA in 2002. The OCC preemption will thus have profound impacts on the market and on the scope of protection against abusive lending.

While the OCC boasts that national banks are not involved in predatory lending to any discernible degree, NCRC finds it implausible that a group of lenders representing nearly one third of the marketplace are involved, purposefully or unwittingly, in only a marginal amount of abusive activity. To take just one example, NCRC provided assistance to Maxine Wilson, who spearheaded a lawsuit involving more than 400 families in New York state against a number of financial institutions and real estate developers. The lawsuit also involves national banks. In this case, the national banks did not make the predatory loans, but they purchased them.

Conclusion

To start the new year, the OCC acted in a manner directly contradictory with their responsibilities of enforcing CRA, anti-discrimination laws, and safety and soundness statutes. The OCC's audacious preemption order is a dire threat to housing and community development. It is a direct threat to the ability of thousands of hard-working families to hold onto to their American Dream of homeownership. Congress must act quickly to undo the OCC's action before the scourge of predatory lending accelerates. Congress must repeal the OCC's order as well as the preemption actions of the Office of Thrift Supervision and the National Credit Union Administration. Congress must also enact a comprehensive anti-predatory law that does not preempt state law along the lines of Senator Sarbanes and Representative Schakowsky's bills.

NCRC stands ready to work with you in these vital endeavors.

Testimony of
Independent Community Bankers of America
On

"Congressional Review of OCC Preemption"

before the
Subcommittee on Oversight and Investigations

of the

House Financial Services Committee

January 28, 2004

Karen M. Thomas

Independent Community Bankers of America

Washington, DC

Madam Chairman, Ranking member Guiterrez, and members of the Committee, my name is Karen Thomas. I am Director of Regulatory Affairs and Senior Regulatory Counsel for the Independent Community Bankers of America ("ICBA"),[1] and I am pleased to appear today on behalf of ICBA to share with you our views on the Office of the Comptroller of the Currency's (OCC) preemption rule.

Earlier this month, OCC finalized two rules designed to clarify its exclusive authority over national banks. The first rule declares that certain state laws that "obstruct, impair, or condition" a national bank's exercise of its lending and deposit-taking activities are preempted. While the final preemption rule sets forth the areas of state law generally preempted as applied to national bank activities, the OCC also reaffirms that there are state laws, such as criminal laws and laws on contract and debt collection, that create the environment in which a national bank operates that will continue to apply to national banks.

A second, companion rule affirms the OCC as the exclusive supervisory authority for national bank activities. While conceding that states have the authority to enforce rules such as fire codes and environmental laws, the agency made clear that any action involving the exercise of a national bank's power granted by the federal government is solely the province of the OCC and not state or local officials.

When proposed, these rules engendered heated controversy and debate—pro and con. We understand that to address criticism that the rules would result in inadequate protection of consumers, the OCC also included two provisions designed to prevent national banks from engaging in predatory lending. Namely, national banks are prohibited from making consumer loans predominantly on the foreclosure or liquidation value of the collateral without regard to the borrower's ability to repay the loan according to its terms. And, national banks may not engage in unfair or deceptive practices within the meaning of Section 5 of the Federal Trade Commission Act.

With issuance of the final rules, the controversy over the rules remains. Strong views and feelings have been expressed on both sides as to the legitimacy and appropriateness of the rule.

Summary of ICBA Position
In October, 2003, ICBA provided its views to OCC on the proposed rule. A copy of our comment letter describing our views in more detail is attached to this testimony.

In general, as expressed in our comment letter, the ICBA believes it would have been preferable for the OCC to continue to analyze how individual state laws impact national banks and to make preemption determinations on a case-by-case basis, rather than adopt a broad general preemption regulation. In our judgment, the importance of the federal-state relationship mandates that whenever preemption is undertaken, it should be carefully

[1] ICBA is the primary voice for the nation's community banks, representing more than 4,600 institutions with 17,000 locations nationwide. For more information, visit www.icba.org.

considered in the context of an individual statute or statutory provision. The merits of preemption will vary from case to case and require that each case be evaluated on the basis on those particular merits. The OCC proposal, though, in our view offered a basis for guidelines or a policy statement on the analysis the agency should undertake in reviewing individual state laws when presented with a preemption issue. Overall, we are concerned that the scope of the OCC rule may not maintain the creative balance that characterizes our unique dual banking system.

The issue is: did the OCC go too far? Our concern is that they may have, but for us it is not a clear-cut case.

Impetus for the Rule

The ICBA understands the impetus for the OCC rule and the desire to bring clarity to the preemption issue. In recent years, the OCC has faced numerous court cases challenging its authority to preempt state laws that might apply to national bank activities. (Through the years, the OCC has had an enviable winning record in preemption cases.) In addition, proliferation of state anti-predatory lending legislation has helped move the issue of preemption to the forefront, most recently with the OCC's preemption of a Georgia anti-predatory lending statute. The final preemption rule is designed to clarify the general applicability of state law to national banks, outline the types of state laws that are preempted (as well as those that generally are not), and provide national banks with a level of certainty in conducting their operations.

Regulatory Burden

Our testimony is in the context of the concern that community bankers in various states have expressed about the growing trend among state legislatures to pass aggressive consumer protection measures that, although well-intended, increase banks' regulatory burden and have negative unintended consequences for consumers and bank customers.

Consequently, ICBA has strongly supported on a number of occasions federal preemption of state laws as they apply to national banks. For example, we have supported the OCC when it preempted individual state laws such as the Georgia anti-predatory lending statute, state laws banning ATM fees, and insurance sales laws that restrict how banks can market and sell insurance.

According to the OCC, it adopted the two rules to assist national banks and their customers because "the imposition of an overlay of state and local standards and requirements on top of the federal standards to which national banks already are subject, imposes excessively costly, and unnecessary, regulatory burden." This statement resounds well with community bankers as they face an ever-growing mountain of regulation.

For example, Georgia bankers faced a serious problem as a result of the state's aggressive law to combat predatory lending. The penalties attached to the loan, not just to the original lender. Secondary market investors stopped buying loans originated in Georgia because they were not willing to take the risk that they might purchase a loan considered

predatory. Consequently, liquidity in the market dried up, and secondary market lending slowed significantly. Following actions by the National Credit Union Administration and the Office of Thrift Supervision to preempt the Georgia law for federal credit unions and federal thrifts, the OCC preempted it for national banks and, as a result of a parity clause in the Georgia law pushed for by Georgia community bankers, state chartered banks were also exempted. Had the Georgia statute not been preempted, Georgia consumers would have been seriously disadvantaged in their ability to secure mortgage loans.

Likewise, state and local laws banning ATM fees have not benefited the consumer. When presented with a state law prohibiting them from charging non-customers a fee for using their ATMs, banks have elected not to permit non-customer use. While consumers had previously had a choice to use their own bank's ATM and not incur a fee, or use another bank's ATM for a small fee, the ATM fee ban resulted in less service and less convenience for consumers. These state and local laws have been declared by the courts to be preempted as to national banks.

Consumer Protection

Consumers deserve to have accurate information about the financial products and services they are buying and to be protected from unscrupulous financial services providers and unfair or misleading practices.

In the context of analyzing whether consumers will be adequately protected under OCC's rule it is important to keep several considerations in mind.

First, OCC's rule expressly affirms that national banks must treat all customers fairly and honestly by stating that a national bank shall not engage in unfair or deceptive practices within the meaning of section 5 of the Federal Trade Commission Act (FTCA). A practice is considered unfair or deceptive if there is a representation, omission, act or practice that is likely to mislead; if it would be deceptive from the perspective of a reasonable consumer; and if it is material in the context of the transaction.

The OCC has previously taken actions under the FTCA against national banks, and affirms it will continue to review unfair and deceptive acts or practices on a case-by-case basis. The parameters in the FTCA ban against unfair and deceptive practices are the very essence of many of the state laws against predatory lending. Therefore, national banks do not operate in a vacuum, and the ICBA agrees that it is appropriate to reaffirm that national banks are subject to the FTCA prohibitions against unfair and deceptive practices.

Second, the new rule has added an anti-predatory lending standard. It is intended to prevent national banks from making a consumer loan where repayment is unlikely and would result in the lender seizing the collateral. The ICBA agrees with the OCC that it is generally inappropriate to base a transaction solely on the value of the collateral that supports it. The final rule has made appropriate accommodation for exceptions to the general rule, such as reverse mortgages.

Finally, it is also important to recognize that national banks are subject to a broad panoply of consumer protection statutes enacted by Congress. Beginning with the adoption of the Truth-in-Lending Act in 1968, national banks must adhere to many consumer protection statutes, including the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act, the Truth in Savings Act and other statutes designed to protect the interests of consumers. Federal banking regulators ensure compliance with these requirements through regular, rigorous examination and supervision.

To stop abusive lending practices, efforts and energy must be focused on the non-depository institutions not subject to regular examination and supervision that are the source of many predatory activities. Saddling the entire lending industry with additional burdens only drives up the costs of credit. Well-intended statutes actually may make the environment more fertile for predators by driving legitimate—and supervised—lenders out of the market and driving marginal borrowers towards predators who already ignore existing laws. Or, as was the case in Georgia, possibly drying up funding sources.

Impact on Dual Banking System

The dual banking system, with bank chartering, supervision and regulation divided between the federal government and the states, has served our nation well for more than 100 years. The ICBA believes that the dual banking system should be protected while also ensuring consumers have access to a full range of competitive banking products regardless of their bank's charter. Over the years, the lines of distinction between state and federally chartered banks have blurred and the differences have diminished. Nevertheless, support for a dual banking system remains vigorous among community bankers who value the productive tension between state and federal regulators. One set of rules issued by one federal banking regulator is viewed as an undue concentration of power by many community bankers.

What we do not know is whether the OCC's preemption rule will disturb the balance of the dual banking system. While only 25 percent or so of bank charters are national charters, national banks hold more than 55 percent of bank industry assets. We must be careful lest one charter, state or national, gains sufficient advantages over the other, and tips the balance in favor of that charter. If sufficient numbers of banks switch charters as a result, the viability of the dual banking system could be in question.

OCC preemption of state laws is one side of the coin. The other side is state actions that impinge on the charter powers of national banks and state actions that undermine appropriate federal supervision and regulation. For example, industrial loan companies, which are chartered in a few states, have the potential to undermine supervision and regulation at the holding company level while breaching further the separation of banking and commerce, as Federal Reserve Chairman Greenspan has warned.

Conclusion

The principle of federal preemption of state law is a long and well-established one. However, where the lines should be drawn is subject to continuing debate. Preemption is

a complex subject that requires a balancing of interests. While many community banks support some preemption, many are also uncomfortable with a policy of blanket preemption. Creating a broad regulation on preemption will not eliminate challenges to the OCC's authority to preempt state law. Indeed, court challenges to the final rule have already begun. We are concerned that a broad preemption may have unintended and unforeseen consequences and would prefer an analysis of the unique elements of particular state laws in particular circumstances before a decision to preempt is made.

INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

October 6, 2003

Office of the Comptroller of the Currency
250 E Street, SW
Public Information Room
Mailstop 1-5
Washington, DC 20219
Attention: Docket No. 03-16

Bank Activities and Operations; Real Estate Lending and Appraisals;
Preemption of State Laws

Dear Sir or Madam:

In recent years, the Office of the Comptroller of the Currency (OCC) has been confronted by court cases challenging its authority to pre-empt various state laws as applied to national bank activities. State legislation against predatory lending has helped move the issue of preemption to the forefront, most recently with the OCC preemption of a Georgia anti-predatory lending statute. As a result, the OCC has proposed a general regulation to establish parameters that will clarify the general applicability of state law to national banks and to outline what state laws are pre-empted. The Independent Community Bankers of America (ICBA)[2] appreciates the opportunity to comment on this proposal.

Generally, the ICBA believes that it would be preferable for the OCC to continue to analyze individual state laws on a case-by-case basis. The need to preserve the dual banking system and the importance of the federal-state relationship mandate that whenever preemption is undertaken, it be carefully considered in the context of an individual statute or statutory provision. The OCC proposal, though, offers a basis for guidelines or a policy statement on how the agency will review individual state laws if presented with a preemption issue. And, given the importance that state law has in real estate transactions and transfers, the ICBA does not believe it would be appropriate for the OCC to state that its regulations "occupy the field." In our judgment, the scope of the OCC proposal would not maintain the creative balance that characterizes our unique dual banking system.

[2] ICBA is the primary voice for the nation's community banks, representing some 4,600 institutions at more than 17,000 locations nationwide. ICBA's members hold more than $526 billion in insured deposits, $728 billion in assets and more than $405 billion in loans for consumers, small businesses and farms. They employ nearly 231,000 citizens in the communities they serve.

Background

As national banks increasingly operate in multiple jurisdictions, the OCC has been asked to address how different state laws apply to national banks. According to the agency, "without further clarification of this issue, national banks, particularly those with customers in multiple states, face uncertain compliance risks and substantial additional compliance burdens and expense." Therefore, the OCC is taking this step to establish a regulation that will provide more comprehensive standards regarding the applicability of state laws to lending, deposit taking, and other authorized activities of national banks.[3]

Congress created the national bank charter in 1863, fully intending to vest authority over these charters with the OCC. The OCC points out that the United States Supreme Court articulated restrictions on state authority over entities created by the federal government as early as 1819, nearly 200 years ago, and "the allocation of any supervisory responsibility for the new national banking system to the states would have been inconsistent with this need to protect national banks from state interference."

Under the doctrine of federal preemption, a state law is pre-empted in one of three ways: (1) Congress expressly pre-empts state law; (2) Congress establishes a framework of regulation that "occupies the field" and leaves no room for state action; or, (3) state law conflicts with federal law. While the OCC's proposal would outline areas of state law generally pre-empted as applied to national bank activities, the OCC also reaffirms that there are state laws, such as criminal laws and laws on contract and debt collection, that do now and would continue to apply to national banks. Generally, the proposal would provide that state laws do not apply to national banks if they obstruct, in whole or in part, or condition, a national bank's exercise of powers granted under federal law.

It is important to recognize that the U. S. Supreme Court and other courts on frequent occasions have upheld the OCC when the agency has determined that federal law pre-empts state law. For example, courts have overturned attempts by state and local municipalities to restrict ATM fees assessed by national banks. The OCC has also been upheld when it pre-empted state laws attempting to restrict national bank activities involving insurance sales (e.g., West Virginia and Massachusetts[4]). Other state laws that courts have agreed were properly pre-empted by the OCC include laws on state licensing, filing requirements, real estate loan terms, advertising, permissible rates of interest, permissible fees and non-interest charges, management of credit accounts, due-on-sale clauses, leaseholds as acceptable security, and mandated statements and disclosures. Frequently, when the OCC preempts a state law for national banks, the state legislature modifies or repeals the law so that state-chartered banks are not disadvantaged by the preemption.

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[3] Earlier this year, the OCC issued a proposal that would reaffirm its exclusive authority to examine national banks.

[4] It is important to note that the OCC did not pre-empt the entire statutory scheme, but only those provisions that would be incompatible with national banks exercising their powers.

General Comments on a Preemption Regulation

Until now, the OCC has approached the preemption of individual state laws on a case-by-case basis. This proposal would establish a broad regulation that affirms steps that the OCC has taken over the years to reaffirm its authority in regulating the activities of national banks. However, the ICBA believes that the OCC should continue to undertake a case-by-case analysis before pre-empting any state law rather than establishing a broad regulation to clarify what laws are pre-empted.

As the OCC points out in the proposal, there would be advantages to establishing a broad regulation. First, it would establish a set of parameters that might avoid involving agency resources in analysis of individual challenges to the authority of national banks. In the area of real estate lending, the concept of a single national standard has a great deal of appeal as real estate lending becomes more national in scope and borrowers have access to creditors from across the United States.

However, while there is an appeal to the efficiency of having a preemption regulation, the ICBA believes the OCC should continue to analyze individual laws on a case-by-case basis. As the OCC points out, the principle of federal preemption of state laws is a long established one. However, where the lines should be drawn is subject to continuing debate, as evidenced by the discussions surrounding the recent Congressional debates over renewal of the Fair Credit Reporting Act's preemption provisions. The ICBA does not believe that creating a broad regulation on preemption for national bank activities will eliminate challenges to the OCC's authority to pre-empt state law, especially since the OCC acknowledges that many state laws will still govern the activities of national banks, such as general laws on contract and criminal laws. The ICBA is also concerned that a broad preemption may have unintended and unforeseen consequences. Therefore, the ICBA recommends that the OCC continue its current course of preemption of individual state laws on a case-by-case basis.

Specific Issues

Real Estate Transactions

Part 34 of current OCC regulations establishes the general authority of a national bank to make real estate loans. According to the OCC, since Congress initially authorized national banks to make real estate loans in 1913, it has gradually expanded that authority until the agency now has broad rulemaking powers concerning national bank real estate lending. This proposal would more completely outline what state laws are pre-empted, although the OCC also requests comment on whether it should determine by regulation that it "occupies the field" for national bank real estate activities, thereby pre-empting *all* state restrictions on national bank real estate lending.[5]

[5] One concern that has been raised is the impact this proposal might have on home equity lending in Texas. Until very recently, Texas state law banned home equity loans, and although now authorized, there are very stringent restrictions on home equity lending. If the proposal is adopted without change, national banks in Texas might be able to offer home equity loans regardless of state law restrictions.

As noted above, the ICBA believes that the OCC should continue to analyze individual state laws on a case-by-case basis. Therefore, it would be inappropriate to provide that the OCC "occupies the field" on real estate lending for national banks. It is important to recognize that real estate transactions are essentially creatures of state law. In the proposal, the OCC affirms that national banks will continue to be subject to state law in a variety of contexts, notably contracts and criminal law. State law will continue to govern many of the elements of every real estate transactions, such as the filing of liens, recording fees, home inspections and foreclosure. Therefore, it would be inappropriate for the OCC to assert that it "occupies the field" in real estate lending as applied to national banks.

Principles Governing National Bank Real Estate Lending.

Some have suggested that OCC preemption would leave real estate lending by national banks "unregulated," a charge the OCC strongly denies. Rather, the OCC asserts that national banks are subject to a variety of federal laws and regulations that govern lending activities, as well as being subject to comprehensive supervision. For example, the OCC recently affirmed its authority to enforce FTC rules on unfair and deceptive practices against national banks. National banks are also subject to restrictions in the Truth-in-Lending Act and RESPA. The OCC recently issued two advisories that reaffirm these restrictions and offer guidance to help national banks avoid predatory practices (AL 2003-2 and AL 2003-3 issued February 21, 2003), although the OCC has frequently stated that, "evidence that national banks are engaged in predatory lending practices is scant." If the OCC intends to occupy the field in the area of real estate lending, it will be critically important that the agency devotes sufficient resources to ensure that these laws and regulations are properly enforced if the OCC is to avoid criticism of the preemption.

Collateral Value. To be sure that there is no question that national bank real estate lending is subject to regulation and supervision even if state laws are pre-empted, the OCC would reaffirm two principles that govern national bank real estate lending activities. First, real estate loans should not be based predominantly on the value of collateral without regard to the borrower's ability to repay, a principle that this proposal would codify.

As noted, the OCC issued guidance earlier this year to help national banks avoid predatory practices in real estate lending or real estate loan purchases. According to Comptroller of the Currency John Hawke, the "guidance provides a framework to deal effectively with predatory lending without setting up a rigid system that creates burdens and obstacles for lenders to serve low-income customers." The OCC has often reaffirmed that it is practices used in the context of an individual loan and not particular loan features or products that make a loan predatory.

The ICBA believes that the OCC should recognize that this is also true when a loan is based on the value of the collateral. The ICBA agrees with the OCC that is generally inappropriate to base a transaction solely on the value of the collateral that supports it. However, it is also important to provide for exceptions from the restriction. Community bankers may make a loan to an individual with questionable or unverifiable income, such as those who are self-employed or starting a new business, based on the collateral offered; a hard ban on lending based on the underlying collateral would

disadvantage these borrowers or any other borrowers with erratic cash flows. Reverse mortgages, which are becoming increasingly popular, might also be difficult to make if the proposal banned lending based on collateral value. And, where a borrower is selling one home and purchasing a second before the first has sold, the collateral value may be critical to allowing the bank to make the second loan while the mortgage on the first home is still outstanding. Therefore, the ICBA encourages the OCC to clearly allow for exceptions and not codify a firm prohibition.

The ICBA is also concerned about any guidance or regulation that sets forth a specific requirement that requires analysis of a borrower's ability to repay the loan. General loan underwriting guidelines and rules on safety and soundness incorporate the concept. However, specific codification of this notion could have unintended consequences. Once such a concept is clearly established in a regulation, it creates a new burden on banks to document compliance and raises the bar on documentation demands. Examiners will want to confirm that this element was explicitly included in the loan underwriting analysis, mandating more extensive documentation. Even if the OCC does not emphasize the need for such documentation in their examination process, banks are going to need to document compliance to minimize the legal risk associated with lawsuits for failing to conduct this analysis. Lack of a clear definition of what constitutes "ability to repay" further compounds this risk, and further eliminates any potential judgment factor on the part of lending officers. Ultimately, though, it would be ironic if the OCC were to implement a provision that created unnecessary burden with no demonstration of commensurate benefit at a time when the agencies are conducting an extensive review of regulations to assess regulatory burden under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).

Treating Customers Fairly. The second principle that the proposal would reaffirm is that national banks should treat all customers fairly and honestly. This standard, codified in the FTC rule against unfair and deceptive practices, serves as a bar against practices such as loan flipping and home equity stripping.

A practice is considered unfair or deceptive if there is a representation, omission, act or practice that is likely to mislead; if it would be deceptive from the perspective of a reasonable consumer; and if it is material in the context of the transaction. Such a practice would violate the FTC regulation if there were substantial consumer injury; the injury is not outweighed by benefits to the consumer; and the injury caused by the practice is not one the consumer could reasonably have avoided. The OCC prefers to approach unfair and deceptive practices on a case-by-case basis and the proposal would not change that.

The ICBA agrees that it is appropriate to reaffirm that national banks are subject to the FTC prohibitions against unfair and deceptive practices. Even though the OCC has often stressed that there is little evidence to suggest that banks engage in predatory practices,[6] the ICBA believes that it is appropriate to reaffirm these standards for national

[6] See, e.g., Remarks by the Comptroller of the Currency before Women in Housing and Finance, Washington, DC, September 9, 2003; Statement of the Comptroller of the Currency, July 31, 2003, regarding National City Preemption Order and Determination; OCC Press Release, February 21, 2003.

banks. It reaffirms that the industry strives to maintain the highest level of integrity in lending practices. The ICBA also strongly agrees with the OCC that it is best to approach these situations on an individual case-by-case analysis, since each transaction will be different and analysis of whether a practice is unfair or deceptive will depend on the unique circumstances surrounding an individual transaction, just as the analysis of whether a loan is predatory depends on the unique set of circumstances of a particular transaction. However, the ICBA also believes that it is critical that the agency ensures the standard is applied consistently within regions and across regions, and that it is vitally important any standard be applied consistently with other banking regulators to avoid the appearance of favoritism and to avoid regulatory arbitrage.

State Laws Pre-empted. The proposal would more specifically outline the types of state laws that the OCC regulation would pre-empt. The list is not intended to be exhaustive and could be expanded. Currently, the proposal lists the following areas of state laws that would be pre-empted for national bank real estate lending:

- Licensing, registration, filings or reports by creditors
- Requirements on credit enhancements such as private mortgage insurance
- Loan-to-value ratios
- Terms of credit, including interest rates, repayment schedules, minimum payments, and term to maturity
- The aggregate amount of funds that may be loaned upon the security of real estate
- Escrow accounts, impound accounts and similar arrangements
- Security property, including leaseholds
- Access to, and use of, credit reports
- Mandated statements, disclosure and advertising
- Processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages
- Disbursements and repayments
- Rates of interest
- Due-on-sale clauses
- Covenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan

Although the ICBA believes that preemption should be carried out on a case-by-case basis, as is done now, the items on this list are likely areas for preemption. If the OCC agrees with the ICBA that it should continue to review state laws on a case-by-case basis, this list would be appropriate for guidelines on what areas of state law generally would be considered pre-empted.

State Laws NOT Pre-empted. Generally, state laws in the following areas would not be pre-empted under the proposal: contracts, torts, criminal law, debt collection, acquisition and transfer of real property, taxation or zoning.[7] However, merely classifying a statute as criminal law, for example, or including a criminal penalty will not automatically exempt the statute from federal preemption. Rather, the OCC would

[7] According to the OCC, these laws generally establish the context in which national banks operate but do not directly infringe on national bank activities.

consider the substance of the state statute in determining whether it is pre-empted. The ICBA believes this list is generally appropriate and that it is appropriate for the OCC to continue to review individual state laws for preemption.

Deposit-Taking, Other Lending and Bank Activities

Since preemption issues are not restricted to real estate lending, the OCC proposal would also address preemption of state laws in other areas.

For deposit-taking activities, the proposal would specifically pre-empt state statutes on abandoned and dormant accounts;[8] checking accounts, mandated statements and disclosure requirements; funds availability; savings accounts orders of withdrawal; state licensing or registration requirements and special purpose savings services. Laws that would *not* be pre-empted are those dealing generally with contracts, torts, criminal law, debt collection, acquisition and transfer of property, taxation or zoning. If the OCC determines that a general preemption is appropriate, the ICBA concurs with this list. However, if the OCC agrees with the ICBA that case-by-case analysis should be undertaken, then this list would be appropriate for guidelines or an OCC policy statement addressing preemption of these types of state laws.

For non-real estate lending, the proposal would pre-empt the same types of state statutes as it would for real estate lending activities, i.e., state statutes on licensing, registration, creditor reports; credit enhancements such as insurance; loan-to-value ratios; credit terms, including repayment terms; escrow accounts; security property, including leaseholds; access to and use of credit reports; mandated statements, disclosures or advertising; disbursements and repayments; and interest rates. As with the proposal for real estate lending, the proposal would establish a safety-and-soundness based anti-predatory lending standard that would require that loans not be made primarily on the value of the collateral without regard for the applicant's ability to repay. It would also emphasize that loans would be subject to the FTC rules against unfair and deceptive practices. The ICBA does not object to these parameters.

Operating Subsidiaries

Under the Gramm-Leach-Bliley Act, an "operating subsidiary" of a national bank is defined as a subsidiary that only engages in activities that the national bank could undertake. The OCC has taken the position that any preemption of state laws that would apply to a national bank also apply to national bank operating subsidiaries. This is similar to the position taken by the Office of Thrift Supervision (OTS) with regard to subsidiaries of federal thrifts. Recently, a court in California upheld an OCC action pre-empting California law for the activities of a mortgage subsidiary of a national bank.

Currently, a court case in Connecticut, supported by 35 state attorneys general and 43 state banking commissioners, has challenged this position. The Connecticut case addresses whether a mortgage subsidiary of a national bank is subject to state licensing laws. Connecticut contends that the mortgage subsidiary must abide by Connecticut laws

[8] The proposal would not pre-empt general laws on unclaimed property and the requirement to turn that property over to state authorities. The regulation would pre-empt statutes that define when an account is deemed abandoned or dormant.

on licensing and registration for mortgage lenders. The OCC contends that, as an operating subsidiary of a national bank, the company is exempt.

While the ICBA does not disagree with the position that any state law that would be pre-empted for the parent bank would be pre-empted for an operating subsidiary, we are concerned that a general preemption for operating subsidiaries is overly broad, regardless of preemption for the parent. Our concerns are allayed somewhat since operating subsidiaries of national banks are restricted to the same types of activities permitted for the bank itself. While we continue to believe that a case-by-case approach would be best, if the agency decides to move forward with a broader regulation, the ICBA recommends that the final rule make very clear that this preemption is limited to operating subsidiaries as distinct from other types of subsidiaries of a national bank. It should also be made especially clear that that the preemption exists only because it would apply where the bank, instead of the subsidiary, was conducting the activity.

Conclusion

The ICBA believes that it would be appropriate for the OCC to continue to approach matters of federal preemption of state law on a case-by-case basis, especially since these are sensitive issues and since each statute is unique and should be considered carefully. A broad regulation establishing the parameters of preemption does not avoid challenges to OCC authority; believing a regulation will settle the issue may be illusory.

The ICBA is also concerned that a broad preemption such as that contemplated by this proposal may have negative implications for the dual banking system. Instead of a broad preemption regulation, the ICBA urges the OCC to adopt the proposal as guidelines or a statement of policy for how it will review state laws regarding federal preemption. However, if the agency decides to adopt a regulation, then the ICBA believes that the parameters set out in the proposal for which state laws will be pre-empted as applied to national banks are appropriate.

Thank you for the opportunity to comment. If you have any questions or need additional information, please contact Robert Rowe, ICBA's regulatory counsel, at 202-659-8111 or at robert.rowe@icba.org.

Sincerely,

C. R. Cloutier

C. R. Cloutier
Chairman

For Release Upon Delivery
9:30 a.m., January 28, 2004

TESTIMONY OF

JULIE L. WILLIAMS

FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

of the

COMMITTEE ON FINANCIAL SERVICES

of the

U.S. HOUSE OF REPRESENTATIVES

January 28, 2004

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. Introduction

Madam Chairwoman, Ranking Member Gutierrez, and members of the Subcommittee, I appreciate the opportunity to discuss the OCC's recent rulemakings pertaining to the applicability of State laws to national banks. I will begin by describing briefly what our new rules do, and, in order to address some confusion that exists, what they do *not* do. Then, I will explain why we took the actions we did and why we acted *when* we did. Finally, my testimony will address the principal arguments that have been advanced by those who question these regulations.

Madam Chairwoman, the hearings you have convened touch on fundamental characteristics of the national bank charter, fundamental responsibilities of the OCC, and the essential attributes of this country's dual banking system. I welcome the opportunity to explain how our rules further the longstanding purposes of the national banking laws, reinforce and reaffirm the high standards of integrity and fair treatment of customers that we expect of national banks, and preserve the distinct roles of Federal and State regulators that define our dual banking system.

II. The OCC's Regulations

Earlier this month, the OCC issued two final rules that address the applicability of State law to national banks. The first regulation, which follows the same approach taken by the OTS in its preemption regulations applicable to Federal savings associations, clarifies the extent to which the operations of national banks are subject to state laws (the preemption rule). The second regulation concerns one aspect of the OCC's exclusive "visitorial powers" with respect to national banks (the visitorial powers rule).

Increasingly in recent years, States – and even cities and counties – have enacted laws that attempt to constrain powers national banks are authorized to exercise under Federal law. In addition to conflicting with Federal authorities, these efforts have resulted in greater uncertainty about the standards applicable to national banks' operations and in costly litigation to resolve that uncertainty. One important purpose of our regulations is to provide the clear guidance needed to ensure that national banks operate under uniform, predictable Federal standards. I next describe each rule in turn.

The Preemption Rule

The preemption rule adds provisions to our regulations expressly addressing the applicability of certain types of state laws to national banks' lending, deposit-taking, and other Federally authorized activities. With regard to all three categories, the preemption rule states that, except where made applicable by Federal law, state laws do not apply to national banks if they "obstruct, impair, or condition" the bank's exercise of powers granted under Federal law. In the lending and deposit-taking areas, the preemption rule then lists certain types of state laws that are preempted by Federal law and therefore are not applicable to national banks.

For lending, examples of preempted laws include laws that restrict or prescribe the terms of credit, amortization schedules, permissible security property, permissible rates of interest, escrow

accounts, disclosure and advertising, and laws that require a state license as a condition of national banks' ability to make loans. For deposit-taking (in addition to laws dealing with disclosure requirements and licensing and registration requirements), the laws listed include laws that address abandoned and dormant accounts, checking accounts, and funds availability. These lists are not exclusive, and the courts, or the OCC, may subsequently conclude that other types of laws also are preempted under our rule and the applicable principles of Constitutional law. The regulation addressing other authorized national bank activities does not list particular types of State laws that are preempted, but it spells out the same basic preemption standard applicable to any national bank power. This standard is distilled from decisions of the U.S. Supreme Court and is not intended to establish any new standard distinct from the standards that the Supreme Court has expressed in its decisions under the National Bank Act dating back over 130 years.

We have taken the extra step of including in our preemption rule two new provisions to ensure that the federal standards under which national banks operate directly address abusive or predatory lending practices. First, the preemption rule prohibits national banks from making any consumer loan based predominantly on the foreclosure or liquidation value of a borrower's collateral, rather than on the borrower's ability to repay the loan according to its terms. This anti-predatory lending standard applies uniformly to all consumer lending activities of national banks, regardless of the location from which the bank conducts those activities or where their customers live. It is comprehensive, it is nationwide, and it strikes at the heart of predatory lending, namely lending practices that effectively swindle a homeowner out of his or her home.

Second, the preemption rule provides that national banks shall not engage in unfair and deceptive practices within the meaning of Section 5 of the Federal Trade Commission Act in connection with any type of lending. Section 5 prohibits "unfair or deceptive acts or practices" in interstate commerce. We added an express reference to Section 5 to our rule in response to commenters who urged us to affirm that this Federal standard applies to national banks. We viewed this addition as particularly appropriate in light of the fact that the OCC pioneered the use of Section 5 as a basis for enforcement actions against banks that have engaged in such conduct.

It is important to clarify several things that the preemption rule does *not* do. The final rule *does not* immunize national banks from all state laws, and it does *not preempt* undiscriminating laws of general applicability that form the legal infrastructure for conducting a banking or other business. Examples of laws that are not preempted are also identified in the preemption rule and include state laws on contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes, and torts. In addition, any other law that only incidentally affects national banks' exercise of their Federally-authorized powers to lend, take deposits, and engage in other federally-authorized activities would not be preempted under the final rule. This distinction is solidly founded in decisions of the U.S. Supreme Court.

Although some aspects of state anti-predatory lending laws – such as state restrictions on particular loan terms and state prohibitions on particular loan products – are preempted by the rule, the rule *does not preempt anti-discrimination and fair lending laws*. There appears to have been some misunderstanding on this point, perhaps because some state predatory lending laws

have "fair lending" in their titles but do not actually address unlawful discrimination in lending.[1] The preemption rule, consistent with Federal judicial precedents,[2] the extensive body of Federal anti-discrimination laws, and the OCC's unyielding commitment to national banks' fair treatment of their customers, does not preempt any law prohibiting discrimination in lending.

In addition to *not* preempting a wide variety of state laws, the preemption rule does not authorize any new national bank activities or powers, such as real estate brokerage. Moreover, while we believe the text and the history of the statute authorizing national banks' real estate lending activities (12 U.S.C. § 371) supports a conclusion that Congress authorized the OCC to occupy the field of national bank real estate lending through regulation, we declined to do so in the preemption rule and took a more targeted approach.

Finally, the preemption rule makes no changes to the OCC's rules governing the activities of operating subsidiaries. The OCC already has rules on the books imposing the same terms and conditions on national banks' activities whether they are conducted directly or through an operating subsidiary. These rules provide that State laws apply to national bank operating subsidiaries only to the extent that those laws apply to the parent bank. By virtue of these pre-existing regulations,[3] the preemption rule has the same effect on national bank operating subsidiaries as it has on national banks.

The Visitorial Powers Rule

"Visitorial powers" refer to the authority to examine, supervise, and regulate the affairs of a corporate entity. Under the National Bank Act, the OCC has exclusive visitorial powers over national banks. This provision dates from the earliest days of the national banking system. It is integral to the overall scheme of the national banking system and to the ability of national banks to operate efficiently today, because it helps to assure that the business of banking conducted by national banks is subject to uniform, consistent standards and supervision, wherever national banks operate.

Our existing regulations implemented the visitorial powers statute by providing that state officials are not authorized to inspect, examine, or regulate national banks, except where another Federal law authorizes them to do so.[4] The amendment to the visitorial powers rule that we have just issued clarifies that the scope of the OCC's exclusive visitorial authority applies to the content and conduct of national bank activities authorized under Federal law. In other words, the OCC is exclusive supervisor of a national bank's banking activities. The rule *does not prevent*

[1] *See, e.g.*, the Georgia Fair Lending Act, GA Code. Ann. §§ 7-6A-1 *et seq.*, which does not address lending discrimination.
[2] *See, e.g., National State Bank v. Long*, 630 F.2d 981 (3d Cir. 1980) (New Jersey anti-redlining statute applicable to national banks); *see also Peatros v. Bank of America NT&SA et al.*, 22 Cal 4th 147 (2000) (where Federal law otherwise provides in employment discrimination context, state anti-discrimination statute not necessarily preempted).
[3] *See* 12 C.F.R. §§ 5.34 (operating subsidiaries subject to same "terms and conditions" as apply to the parent bank) and 7.4006 (applicability of State law to national banks). *See also id.* at § 34.1(b) (real estate lending rule applies to national bank operating subsidiaries).
[4] 12 C.F.R. § 7.4000.

state officials from enforcing state laws that do not pertain to a national bank's banking activities, such as health and safety standards or criminal laws of general applicability.

The new visitorial powers rule also clarifies that the National Bank Act does not give state officials authority, in addition to whatever they may otherwise have, to use the court system to exercise visitorial powers over national banks. Thus, state officials may not use the courts to accomplish indirectly what the Federal statute prohibits them from accomplishing directly through administrative action. The visitorial powers rule *does not* preclude states from seeking a declaratory judgment from a court as to whether a particular state law applies to the Federally-authorized business of a national bank.

Finally, like the preemption rule, the visitorial powers rule makes no change to the treatment of operating subsidiaries. Thus, in accordance with previously adopted OCC regulations, States generally can exercise visitorial powers over operating subsidiaries only to the extent that they could exercise visitorial powers over a national bank.

Some of the comments we received during the rulemaking process and some reactions to the final rules characterize them as "radical" or "dramatic" departures from the *status quo*. That characterization is simply incorrect.

The standard used in the preemption rule encapsulates the standards that the United States Supreme Court has applied in national bank preemption cases for well over 130 years. It is phrased in words – "obstruct, impair, or condition" – that are taken directly from those cases. The types of State laws identified as preempted in the rule include types of laws that a Federal court has previously held, or that the OCC has previously opined, are preempted. The types of laws listed as preempted are virtually the same as those listed in OTS regulations that have been on the books since 1996. The clarifications we have added to our existing visitorial powers rule reinforce the point that the statutory prohibition on the exercise of visitorial powers by authorities other than the OCC means what the text clearly says. No one other than the OCC is empowered to regulate or supervise the banking business of national banks unless Federal law provides that authority, and the statutory prohibition cannot be defeated by resort to the courts to impose indirectly standards or sanctions that the statute forbids them to impose directly.

What, then, has changed? What is different is that the legal standards that we have applied, and the legal conclusions that we have reached, for the most part, only on a case-by-case basis – for example, in legal opinions, orders, and sometimes briefs in litigation – are now collected together in one place and codified in our rules. Now, all national banks can rely on specified and predictable standards to define their compliance responsibilities. As I next explain, this is critically important if national banks are to be able to exercise fully the powers that Federal law gives them in order to operate efficiently and compete successfully in today's financial services markets.

III. The OCC's Reasons for Adopting the Regulations

As we explained in the preamble to the preemption rule, markets for credit, deposits, and many other financial products and services are now national, if not international, in scope, as a result of significant changes in the financial services marketplace, particularly in the last 20 years. Now, more than ever before, the imposition of an overlay of 50 State and an indeterminate number of local standards and requirements on top of the Federal requirements and OCC supervisory standards to which national banks already are subject has costly consequences that materially affect a national bank's ability to serve its customers. Moreover, this regulatory burden is unnecessary – in the most literal sense of the word – because it is inconsistent as a matter of law with the Federal character of the national bank charter. Finally, the Federal preemption standards that form the basis of our regulations are so well developed, and have been so consistently applied by the Federal courts over time in an extensive body of judicial precedent, that exclusive reliance on a case-by-case approach is no longer warranted.

The changing financial services marketplace

The changes we see in the market for financial services are the result of a combination of factors, including technological innovations, the erosion of legal barriers, and an increasingly mobile society.

Technology has expanded the potential availability of credit and made possible virtually instantaneous credit decisions. Mortgage financing that once took weeks, for example, now can take only hours, with decisions based on sophisticated credit-scoring derived from centralized credit underwriting facilities. Consumer credit can be obtained at the point of sale at retailers and even when buying a major item such as a car. Consumers can shop for investment products and deposits on-line, from providers whose location may well be irrelevant. With respect to deposits, consumers can compare rates and duration of a variety of deposit products offered by financial institutions located far from where the consumer resides.

Changes in applicable law also have contributed to the expansion of markets for national banks and their operating subsidiaries. These changes have affected both the type of products that may be offered and the geographic region in which banks – large and small – may conduct business. As a result of these changes, banks may branch across State lines and offer a broader array of products than ever before. An even wider range of customers can be reached through the use of technology, including the Internet. Community national banks, as well as the largest national banks, reach customers across State lines and use new technologies to expand their reach and service to customers.

Our modern society is also highly mobile. Forty million Americans move annually, according to a recent Congressional report issued in connection with enactment of the Fair and Accurate Credit Transactions Act of 2003.[5] And when they move, they often have the desire, if not the expectation, that the financial relationships and status they have established will be portable and will remain consistent.

[5] *See* S. Rep. No. 108-166, at 10 (2003) (quoting the hearing testimony of Secretary of the Treasury Snow).

These developments highlight the significance of being able to conduct a banking business pursuant to consistent, national standards, regardless of the location of a customer when he or she first becomes a bank customer or the location to which the customer may move *after* becoming a bank customer. They also accentuate the costs and interference that diverse and potentially conflicting State and local laws have on the ability of national banks to operate under the powers granted by their Federal charter.

When national banks are unable to operate under uniform, consistent, and predictable standards, their business suffers, and their customers may face higher costs or more limited product offerings – or both – as a result. The application of multiple, often unpredictable, different State or local restrictions and requirements prevents them from operating in the manner authorized under Federal law, is costly and burdensome, interferes with their ability to plan their business and manage their risks, and subjects them to uncertain liabilities and potential financial exposure. In some cases, this deters them from making certain products available in certain jurisdictions. As was recently observed by Federal Reserve Board Chairman Alan Greenspan, "increased costs resulting from restrictions that differ based on geography, may lead to an increase in the price or a reduction in the availability of credit, as well as a reduction in the optimal sharing of risk and reward."[6]

It has been suggested that the ability to do business in multiple States under uniform, consistent and predictable standards, primarily benefits the largest banks. In fact, for community and intermediate-sized banks with customers in multiple jurisdictions, this attribute of the national bank charter may have even more practical significance than for a "megabank." Take, for example, a community bank with customers in a multi-state metropolitan area like New York or Philadelphia; or a community bank with customers in a compact multi-state region, such as New England; or any State-based bank in a State in which cities or municipalities enact unique local requirements for bank operations. Community and intermediate-sized regional banks have a smaller base of operations, *e.g.*, a smaller number of loans, over which they are able to spread the overhead costs of legal staff, compliance staff, technology, and printing costs necessary to keep abreast of multiple State (and potentially local) requirements. This drives up their costs, and detracts from their ability to compete effectively with larger banks that have a bigger base of operations over which to apply overhead costs. This, in turn, serves as a disincentive for that bank to incur still more costs by expanding service to customers in a new State. Ultimately, the inability to compete on a cost-effective basis can be a factor that contributes to management decisions to merge or be acquired by a larger institution.

At the OCC, we supervise thousands of community and mid-size national banks, and we are as concerned about the consequences of the inability of those institutions to operate efficiently under uniform, consistent, and predictable standards, consistent with the character of their national bank charter, as we are about the ability of our national "megabanks" to operate under such standards.

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[6] Letter of February 28, 2003, from Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, to The Honorable Ruben Hinojosa (cited by Congressman Hinojosa on November 21, 2003, during House debate on the Conference Report to accompany H.R. 2622 (Conference Report 108-396)).

The Federal character of the national bank charter

Federal law is the exclusive source of all of national banks' powers and authorities. Key to these powers is the clause set forth at 12 U.S.C. § 24(Seventh) that permits national banks to engage in the "business of banking "and to exercise "all such incidental powers as shall be necessary to carry on the business of banking." This flexible grant of authority furthers Congress's long-range goals in establishing the national banking system, including financing commerce, establishing private depositories, and generally supporting economic growth and development nationwide.[7] The achievement of these goals requires national banks that are safe and sound and whose powers are dynamic and capable of evolving so that they can perform their intended roles. The broad grant of authority provided by 12 U.S.C. § 24(Seventh), as well as the more targeted grants of authority provided by other statutes, enable national banks to evolve their operations in order to meet the changing needs of our economy and commercial and consumers.

Moreover, the ability to operate under uniform standards is fundamental to the character of the national bank charter. As we explained in 2002 when we added to our rules new provisions concerning national banks' electronic activities, "freedom from State control over a national bank's powers protects national banks from conflicting local laws unrelated to the purpose of providing the uniform, nationwide banking system that Congress intended."[8]

As we have learned from our experience supervising national banks, from the inquiries we have received, by the extent of litigation in recent years over these state efforts, and by the comments we received during our rulemakings, national banks' ability to conduct operations to the full extent authorized by Federal law has been impaired as a result of increasing efforts by States and localities to apply State and local laws to national banks.

For example, commenters on our proposal to adopt the preemption rule noted that the variety of state and local laws that have been enacted in recent years – including laws regulating fees, disclosures, conditions on lending, and licensing – have created higher costs, increased risks, and operational impediments.[9] Other commenters noted the proliferation of state and local predatory lending laws and the impact that those laws are having on lending in the affected jurisdictions. As a result, national banks must absorb the costs, pass the costs on to consumers, or eliminate various products from jurisdictions where the costs are prohibitive or risks are imprudent.

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[7] For a more detailed discussion of Congress's purposes in establishing a national banking system that would operate to achieve these goals distinctly and separately from the existing system of state banks, *see* 68 Fed. Reg. 46119, 46120 (August 5, 2003) (preamble to the proposed preemption rule). *See also* Office of the Comptroller of the Currency, *National Banks and the Dual Banking System* (publication dated September 2003).
[8] 67 Fed. Reg. 34992, 34997 (May 17, 2002).
[9] Illustrative of comments along these lines were those of banks who noted that various state laws would result in the following costs: (a) approximately $44 million in start-up costs incurred by 6 banks as a result of a recently-enacted California law mandating a minimum payment warning; (b) 250 programming days required to change one of several computer systems that needed to be changed to comply with anti-predatory lending laws enacted in three states and the District of Columbia; and (c) $7.1 million in costs a bank would incur as a result of complying with mandated annual statements to credit card customers.

Commenters noted that this result occurs even in situations where a bank concludes that a law is preempted, simply so that the bank may avoid litigation costs or anticipated reputational injury.

Even the efforts of a single state to regulate the operations of a national bank operating only within that state can have a detrimental effect on that bank's operations and consumers. As we explained in our recent preemption Determination and Order regarding the Georgia Fair Lending Act (GFLA),[10] the GFLA caused secondary market participants to cease purchasing certain Georgia mortgages and some mortgage lenders to curtail their mortgage lending activities in Georgia. National banks have also been forced to withdraw from some products and markets in other states as a result of the impact of state and local restrictions on their activities. The impact of particular state laws on the mortgage market and credit availability is discussed in detail in part IV, below.

Federal preemption precedent

The Constitutional principles supporting the preemption of State laws that limit the powers and activities of Federally-chartered banks have been recognized from the earliest decades of our Nation. The principle of the primacy of Federal law under the Supremacy Clause was first articulated in the Supreme Court's *McCulloch v. Maryland* decision in 1819, a case involving the Federally-chartered Second Bank of the United States. Precedents of the Supreme Court dating back to 1869 have addressed preemption in the context of national banks and have consistently and repeatedly recognized that national banks were designed by Congress to operate, throughout the nation, under uniform, Federally-set standards of banking operations.

As a result, there is an extensive body of Federal court precedents that reiterate and apply preemption principles to a variety of different types of State laws.[11] To date, the OCC has relied on these precedents to issue many legal opinions of its own that address the applicability of State law. As national banks operate in an increasingly complex and multi-state environment, however, the shortcomings of this case-by-case approach have become increasingly apparent. Legal opinions and judicial decisions may be construed to be confined to their facts. In addition, the financial and opportunity costs to banks of a case-by-case approach may be significant – especially where litigation becomes necessary to establish clear standards upon which a business may prudently rely.

We concluded that continued, exclusive use of a case-by-case approach had become unnecessary and inefficient in light of the substantial and consistent body of Federal judicial precedent. Rather than continuing to address preemption issues on a piecemeal basis, therefore, the

[10] *See* 68 Fed. Reg. 46264 (August 5, 2003).

[11] *See, e.g., Bank of America v. City & County of San Francisco*, 309 F.3d 551 (9th Cir. 2002), *cert. denied*, 123 S.Ct. 2220, 2003 U.S. LEXIS 4253 (May 27, 2003) (the National Bank Act and OCC regulations together preempt conflicting state limitations on the authority of national banks to collect fees for the provision of electronic services through ATMs; municipal ordinances prohibiting such fees are invalid under the Supremacy Clause); *Wells Fargo Bank, Texas, N.A. v. James*, 321 F.3d 488 (5th Cir. 2003) (Texas statute prohibiting certain check cashing fees is preempted by the National Bank Act); *Metrobank v. Foster*, 193 F. Supp. 2d 1156 (S.D. Iowa 2002) (national bank authority to charge fees for ATM use preempted Iowa prohibition on such fees). *See also Bank One, Utah v. Guttau*, 190 F.3d 844 (8th Cir. 1999), *cert. denied sub nom Foster v. Bank One, Utah*, 529 U.S. 1087 (2000) (holding that Federal law preempted Iowa restrictions on ATM operation, location, and advertising).

preemption rules address them comprehensively – by clarifying and codifying prior judicial and OCC interpretations based on long-established Constitutional principles – to provide much-needed clarity to national banks.

IV. The Timing of the Final Rules

Madam Chairwoman, you, as well as some other members of the Committee and some of the commenters on our proposals, have suggested that the OCC should have waited longer before finalizing our rules. Please be assured that we considered timing concerns very carefully, but we ultimately concluded that taking action, following an open and inclusive comment process, which included Members of Congress and their staffs, was both respectful of the role of Congress and the course most consistent with our responsibilities as supervisors of the national banking system.

We reached this conclusion for several related reasons. First, as described earlier in my testimony, the laws under which we acted exist today, and the principles incorporated in our preemption regulation and in the clarification of our visitorial powers rule are not new. The new rules are entirely consistent with *existing* law, namely, the powers Congress has granted national banks – within the past decade and dating back to the original provisions of the National Bank Act. To characterize these regulations as dramatic changes from the status quo is simply incorrect.

Second, the continuing uncertainty about the applicability of State laws has already affected national banks' ability to lend in certain markets and to access the secondary market, a curtailment of their business that is not only inconsistent with their Federally authorized powers but also one that has the potential to adversely affect credit availability as well as detract from the banks' financial strength. Moreover, we believe that the addition of predatory lending standards to our lending rules materially *reinforces* national banks' obligation to treat their customers fairly and operate pursuant to the highest standards of integrity. Delaying the implementation of those standards is, accordingly, inconsistent with our responsibility to ensure that national banks satisfy those obligations.

The trend at the State and local levels toward enacting legislation that seeks to impose costly and inconsistent compliance burdens on national banks has accelerated. These laws are well-intentioned but nonetheless curtail national banks' ability to conduct operations to the full extent authorized by Federal law and disrupt crucial credit delivery systems.

For example, in recent years, various States and localities have enacted predatory lending laws, each employing a combination of standards that differs in some respects from the others, but each typically singling out loan product features and either barring loans with those features or imposing requirements that make it impractically costly for lenders to offer them. The goals of these laws – to eliminate predatory and abusive mortgage lending practices – are laudable and we strongly support their objectives. As Comptroller Hawke has said repeatedly, predatory and abusive practices have no place in the national banking system, and we fully agree that such practices should be promptly addressed where they arise.

However, these State and local law approaches effectively ban loans based on certain loan terms. They generally prohibit certain mortgage loan terms and impose extra compliance obligations when certain other loan terms or conditions are present. They introduce new standards for subprime lending that are untested, sometimes vague, often complex, and, in many cases, different from established and well-understood Federal requirements. They also create new potential liabilities and penalties for any lender who missteps in its efforts to comply with those new standards and restrictions. These laws materially increase a bank's costs and compliance and reputation risks, especially in connection with risk-based pricing to the subprime market.

It is important to understand that this approach, while intended to stop abusive practices, also can work to constrain legitimate risk-priced lending to credit-worthy subprime borrowers.[12] The OCC is as dedicated as any State regulator to ensuring that the institutions we supervise are not engaged in abusive or predatory lending practices. However, our approach is to focus on preventing those *practices*, not on banning or restricting specified loan products or terms in the absence of evidence of abusive, predatory, unfair or deceptive practices.

Generally, State and local predatory lending laws that have such a *product-* rather than *practice-* focus have created uncertainties that adversely affect banks' ability to access the secondary market for legitimate, risk-priced mortgage loans. Let me briefly explain the material, practical significance of this issue.

When a bank is able to sell a loan on a cost-effective basis to Fannie Mae or Freddie Mac, or obtains a rating for a pool of loans that it "securitizes" and sells to investors, the bank is able to liquify its loans and redeploy capital to make additional loans available. If Fannie or Freddie are unwilling to purchase loans made in jurisdictions with specialized predatory lending restrictions and potential liabilities, or if they impose additional costs in return for their willingness to buy such loans, the funds banks have available to make additional credit available are diminished. Similarly, if a bank is unable to obtain a rating from Standard and Poors', Moody's Investors Services, or Fitch Ratings, it will not be able to securitize its loans on a cost effective basis and reallocate capital to make additional credit available. In other words, localized and State-based restrictions on loan terms substantially affect the marketability of such loans, and that, in turn, affects overall credit availability to credit-worthy consumers.

Fannie Mae and Freddie Mac have both issued policies concerning their willingness to purchase residential mortgage loans subject to various state predatory lending laws. Fannie Mae and Freddie Mac will not purchase high cost home loans from **Arkansas, Georgia, Kentucky, Illinois, Maine, Nevada, New Jersey, New Mexico, New York, and Oklahoma**.

[12] It is important to note that many legitimate, risk-priced mortgage loans would be considered "high cost home loans" under some state anti-predatory lending laws. For example, a "high cost" home loan under Georgia's anti-predatory lending law includes mortgages that have total points and fees exceeding 5% of the loan amount if the mortgage is $20,000 or more. On a $30,000 mortgage, this would mean any loan with origination fees of more than $1,500 would be considered "high cost." According to the Mortgage Bankers Association's 2002 Cost Study, the average cost to originate a mortgage in 2001 was $1,744.

S&P, Moody's, and Fitch have also issued policies concerning the inclusion of such loans in structured finance transactions.[13] Under these policies, the rating agencies generally exclude from their rated structured finance transactions loans that carry unquantifiable assignee liability, as do some loans under certain State and predatory lending laws.[14]

As a result, lenders doing business in the States discussed below face the following additional secondary market constraints:

- **Arkansas, Georgia, Illinois, Maine, Nevada, New York, and Oklahoma**. In these states, S&P generally requires that sellers provide representations and warranties that the loans were originated in compliance with all applicable laws and that their compliance procedures effectively identify high cost home loans and determine that the loans do not violate predatory lending laws. Further, S&P requires that the provider of these representations and warranties is sufficiently credit worthy to purchase any loans that are in violation and cover any contingent liability associated with securitizing high cost home loans.[15] Fitch will generally rate securitizations with loans from these jurisdictions subject to additional credit enhancements.[16]
- **Kentucky**. S&P requires sellers to conduct a loan-by-loan review of all high-cost home loans, and provide the representations and warranties noted above before it will allow high cost home loans from Kentucky in rated transactions.[17] Fitch will not allow any high cost loans from Kentucky in rated transactions. In order to rate a transaction including *any* loans from Kentucky, Fitch requires receipt of a certification from a third party unaffiliated with the originators of the relevant loans that such third party conducted due diligence on a random sample of the greater of 5 loans or 10% of the loans from Kentucky and that no high cost home loans were uncovered in the sample. If the review of the sample of loans uncovers any high-cost home loans, Fitch requires a review of every loan in the pool originated in Kentucky.[18]

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[13] *See* Standard & Poor's: Evaluating Predatory Lending Laws: Standard & Poors Explains its Approach (April 15, 2003); Moody's Investor Services: Impact of Predatory Lending Laws on RMBS Securitizations (May 6, 2003); and Fitch Press Release: Fitch Revises its Rating Criteria in the Wake of Predatory Lending Legislation (May 1, 2003).
[14] *See, e.g.*, § 6(b) of the New Jersey Homeownership Security Act; and § 11 of the New Mexico Home Loan Protection Act.
[15] *See* S&P Addresses Arkansas Home Loan Protection Law (July 11, 2003); Standard & Poor's: Evaluating Predatory Lending Laws: Standard & Poors Explains its Approach (April 15, 2003) (Georgia and New York); S&P Addresses Illinois High Risk Home Loans Act (Nov. 17, 2003); S&P Addresses Amendment to Maine Truth in Lending Act (Sept. 12, 2003); S&P Addresses Nevada Anti-Predatory Lending Law; and S&P Addresses Oklahoma Anti-Predatory Lending Law (Nov. 18, 2003).
[16] *See* Fitch Ratings Responds to Arkansas Predatory Lending Legislation (June 20, 2003); Mortgage Bankers Association Industry News: "Fitch to Rate RMBS After Amendment to Georgia Predatory Lending Statute, GFLA" (Mar. 14, 2003); Mortgage Bankers Association Industry News: "Fitch Ratings Addresses Illinois Predatory Lending Legislation" (Dec. 15, 2003); Fitch Ratings Responds to Maine Predatory Lending Legislation (Sept. 29, 2003); Fitch Ratings Responds to Nevada Predatory Lending Legislation (Oct. 3, 2003); Mortgage Bankers Association Industry News: "Fitch: New York State Anti-Predatory Lending Legislation" (Mar. 26, 2003); and Fitch Ratings Addresses Predatory Lending Legislation of Oklahoma (Oct. 30, 2003).
[17] *See* S&P Addresses Kentucky High-Cost Law (Jun. 20, 2003).
[18] *See* Mortgage Bankers Association Industry News: "Fitch Ratings Responds to Kentucky Predatory Lending Legislation" (Jun. 30, 2003); and Mortgage Bankers Association Industry News: "Fitch Ratings Updates Criteria Regarding Predatory Loans" (Jan. 15, 2004).

- **New Jersey**. S&P and Fitch will not rate securitizations with certain high cost home loans from New Jersey.[19] In order to rate a transaction including *any* loans from New Jersey, Fitch requires, as it does in Kentucky, receipt of a certification from a third party unaffiliated with the originators of the relevant loans that such third party conducted due diligence on a random sample of the greater of 5 loans or 10% of the loans from New Jersey and that no high cost home loans were uncovered in the sample. If the review of the sample of loans uncovers any high-cost home loans, Fitch requires a review of every loan in the pool originated in New Jersey.[20]
- **New Mexico.** S&P will rate securitizations containing high cost home loans subject to the additional credit enhancements it requires in Arkansas, Georgia, Illinois, Maine, Nevada, New York, and Oklahoma.[21] Fitch, however, will not rate any transaction containing high cost home loans subject to New Mexico's anti-predatory lending law. Fitch notes that assignee liability may be unlimited in the case of punitive damages, which may be imposed for acts found to be reckless or malicious. Fitch further requires that the seller of any New Mexico loan provide adequate evidence that the transaction will enjoy the benefits of the new law's safe harbor from the law's unlimited liability for assignees and purchasers. In order to be protected by this safe harbor, a purchaser/securitizer must conduct due diligence and provide certain representations and warranties. Because it is unclear what constitutes sufficient "due diligence" under the New Mexico statute, Fitch requires the third party certificate and random sampling it requires in Kentucky and New Jersey.[22]

These constraints translate into cost burdens at each stage of the lending process. For example, a rating agency that is willing to rate a "high-cost" loan securitization at all may, as we have seen, require representations, warranties, sampling, and certifications that go beyond the industry standard for prime loans. Satisfying these extra conditions may require a bank to increase its compliance staff, provide additional training to both existing and new staff, and pay fees to obtain third-party sampling and certification. If the rating agency requires additional credit enhancement, providing that – in the form of a guarantee, for example – will add to the financial cost of the transaction to the bank. Finally, if the bank cannot securitize the loans and must therefore retain them on book, the bank does not realize funds that it could use to make additional loans, the bank will incur carrying costs, and the bank's servicing fee income will be diminished. These costs either will be passed back to the bank's customers or, if the bank concludes they are unacceptably high, will compel the bank to stop making loans covered by state anti-predatory lending laws.

The rating agencies have, however, responded favorably to preemption decisions by the Federal banking agencies. Shortly after Fitch announced that it would not rate residential mortgage backed securitizations containing high cost home loans originated in New Mexico, Fitch also announced that, beginning the day the OCC's preemption rule becomes effective (February 12,

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[19] *See* S&P Permits Additional New Jersey Mortgage Loans Into Related SF Transactions (November 25, 2003).
[20] *See* Fitch Ratings Responds to New Jersey Predatory Lending Legislation (Jun 5, 2003); and Mortgage Bankers Association Industry News: "Fitch Ratings Updates Criteria Regarding Predatory Loans" (Jan. 15, 2004).
[21] *See* S&P Addresses New Mexico's Home Loan Protection Act (Nov. 25, 2003).
[22] *See* Mortgage Bankers Association Industry News: "Fitch Ratings Addresses New Mexico Predatory Lending Legislation" (Jan. 15, 2004).

2004), it *will* rate residential mortgage backed securitizations containing loans subject to any state or local anti-predatory lending laws that were originated by OCC-regulated national banks or their operating subsidiaries without additional credit enhancements.[23] This follows Fitch's August 22, 2003, decisions to rate securitizations without additional credit enhancement by OCC-regulated lenders in Georgia in light of the OCC's Preemption Order and Determination concerning the GFLA,[24] and by OTS-regulated lenders in all jurisdictions in light of the OTS's preemption regulations and various preemption opinions.[25] On October 3, 2003, S&P made the same decision concerning the GFLA Determination and Order,[26] and, on November 25, 2003, having reviewed the OTS's preemption opinions concerning the anti-predatory lending laws in Georgia, New Jersey, New Mexico, and New York, S&P announced that it would no longer apply its published criteria to Federal thrifts and their operating subsidiaries operating in those states.[27]

These decisions are critical because, as we noted in our Preemption Determination and Order concerning the Georgia Fair Lending Act, without a certain secondary market for these loans, banks making risk-priced loans covered by this type of State law will be required to hold more of these loans to maturity. This, in turn, ties up more of a bank's capital as it carries the mortgage assets on its books, and thus adversely affects the ability of the bank to originate or acquire other real estate loans.

As a result of these higher costs and operational challenges, lenders must absorb the costs, pass the costs on to consumers, or discontinue offering various products in jurisdictions where the costs or exposure to uncertain liabilities are prohibitive. Notably, Option One Mortgage Corporation, a subsidiary of Wells Fargo, reportedly ceased funding for loans subject to New Mexico's anti-predatory lending law, which took effect January 1, and GMAC Residential Funding Corporation has significantly curtailed its operations in that state. Similarly, three lenders have announced they will no longer do business in New Jersey because of the State's predatory lending law, and at least 18 have significantly limited their lending activities there.[28] As lenders react like this, consumers will have fewer options for their home loans.

Finally, I must emphasize that our exercise of rulemaking authority was an open, broadly inclusive, and deliberative process in which we informally sought views from a number of perspectives even before proceeding with our preemption proposal. Recognizing that, in today's environment, the ability of national banks to operate under consistent, uniform national standards will be a crucial factor in their business future, the OCC began in 2002 discussing with consumer groups, members of Congress and their staffs, and industry groups the need for regulations to codify well-established preemption precedents and clarify the statute governing the OCC's exclusive visitorial powers. We have been completely open about the issues that concerned us, and the potential actions that we might take. The actions that we ultimately determined to take were not dramatic departures from existing precedent; moreover they were the product of an

[23] *See* Fitch Ratings Addresses Preemption Statement from the OCC (Jan. 16, 2004).
[24] *See* 68 Fed. Reg. 46264 (Aug. 5, 2003).
[25] *See* Fitch Ratings Addresses Preemption Statements from the OTS and OCC (Aug. 22, 2003).
[26] *See* S&P Announces Position on OCC's Preemption Order for the GFLA (Oct. 3, 2003).
[27] *See* S&P Announces Position on OTS Preemption Pronouncements (Nov. 25, 2003).
[28] *See* Paul Muolo and Brad Finkelstein, *Lenders Leaving New Jersey*, Dec. 2003, American Banker-Bond Buyer, Vol 13, No. 3 at 41.

extended and highly inclusive process that was fully cognizant of the interest and role of Congress.

V. Correcting Misconceptions about the Preemption and Visitorial Powers Rules

Some of the comments and reaction we have received in response to our rules seem to reflect fundamental misconceptions about the law on which the rules are based, or the effect of the regulations. I welcome the opportunity to correct these misconceptions.

1. The preemption and visitorial powers rules will not demolish the dual banking system.

Some critics have suggested that by codifying in regulations the exclusivity of the OCC's supervision of national banks and the types of State laws that are, or are not, preempted as applied to national banks, the OCC "will demolish" the dual banking system, or "deprive bankers of a choice of charters." We even heard recently that a State legislator was told that our regulation would lead to dismantling of his State's banking department because it would prevent that department from regulating *State banks*.

Some of this rhetoric is, obviously, fanciful. Other comments in the same vein profoundly short-change the qualities of the State banking systems. More fundamentally, the argument being advanced is simply backwards. Distinctions between State and Federal bank charters, powers, supervision, and regulation are not contrary to the dual banking system; they are the essence of it. Clarification of how the Federal powers of national banks preempt inconsistent State laws is entirely consistent with the distinctions that make the dual banking system dual.

The national and State charters each have their own distinct advantages. But many national banks engage in multi-state businesses that particularly benefit from the efficiency of a uniform, nationwide system of laws and regulations. Customers of national banks enjoy protections that are as strong as -- and in some cases stronger than -- those available to customers of State banks. But they also benefit from the efficiencies of the national banking system, and predictable, uniform, consistent regulation. It is important to remember that the dual banking system offers American consumers a choice -- those who believe the State system offers greater protections, or desirable variety, are free to make that choice.

2. The OCC is using the correct preemption standards in our preemption rule.

Some critics of the regulation have claimed that we are using incorrect preemption standards in our preemption rule. They argue that that preemption should only occur when State law significantly impairs a national bank's *express* rights under Federal law. These critics also argue that the OCC contends that national banks are immune from State law. These assertions misstate both OCC's positions and the relevant judicial standards for preemption.

The OCC is *not* arguing that national banks are immune from State law. As I have mentioned previously, the preemption standards in our new regulation are firmly grounded on standards announced by the U.S. Supreme Court in cases that trace back over 130 years, and our authority to adopt the regulation is solidly based on our statutes. The final regulation specifically -- and

meticulously – explains the sources of our authority to issue the regulation and the standards we use. In a nutshell, the preemption standards the OCC applies derive from Supreme Court and lower Federal court precedents that provide that Federal law can preempt state laws that obstruct (stand as an obstacle), *Hines v. Davidowitz (1941);* impair the efficiency of, *National Bank v. Commonwealth (1869), Davis v. Elmira Savings Bank (1896), McClellan v. Chipman (1896);* or condition the ability of national banks to exercise powers granted under Federal law, *Barnett Bank of Marion County v. Nelson (1996); Franklin (1954)*; and that state "legal infrastructure" laws – such as contract, torts, and real property laws -- that do not restrict the content or extent of powers granted under Federal law are **not** preempted. *National Bank v. Commonwealth (1869); McClellan v. Chipman (1896); B of A v. City and County of S.F. (9th Cir. 2002).*

It is relevant to note in that regard that the laws listed as preempted in our new regulation are virtually identical to those listed as preempted with respect to Federal thrifts in existing regulations of the OTS.

3. There is no presumption against preemption in the case of the national banking laws, as confirmed by Federal case law and the Riegle-Neal Act.

Critics of both the preemption and visitorial powers rules contend that the rules are inconsistent with the presumptive application of state law to national banks, allegedly embodied in the Riegle-Neal Act. This is simply incorrect.

As an initial matter, case law, whether decided before or after Riegle-Neal was enacted, is consistent in holding that there is no presumption against preemption in the national bank context. The Supreme Court has said that a presumption against preemption "is not triggered when the State regulates in an area where there has been a history of significant federal presence."[29] Courts have consistently held that the regulation of national banks is an area where there has been an extensive history of significant Federal presence. As recently observed by the U.S. Court of Appeals for the Ninth Circuit, "since the passage of the National Bank Act in 1864, the federal presence in banking has been significant." The court thus specifically concluded that "the presumption against the preemption of state law is inapplicable."[30] Indeed, when analyzing national bank powers, the Supreme Court has interpreted "grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law."[31]

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[29] *U.S. v. Locke*, 529 U.S. 89, 108 (2000) (explaining *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947)).
[30] *Bank of America*, 309 F.3d at 558-59 (citations omitted).
[31] *Barnett*, 517 U.S. at 32. The *Barnett* Court went on to elaborate:

> [W]here Congress has not expressly conditioned the grant of "power" upon a grant of state permission, the Court has ordinarily found that no such condition applies. In Franklin Nat. Bank, the Court made this point explicit. It held that Congress did not intend to subject national banks' power to local restrictions, because the federal power-granting statute there in question contained "no indication that Congress [so] intended . . . as it has done by express language in several other instances."

Id. at 34 (emphasis in original) (citations omitted).

The relevant text of the Riegle-Neal Act is fully consistent with these conclusions. As explained in the preamble to the visitorial powers rule, the Riegle-Neal Act sorted out *which* state's laws -- host state or home state – regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches, would apply to interstate branches of national banks, and provided that the host state's laws in those areas would apply to national banks ***"except when Federal law preempts the application of such State laws to a national bank."*** The potential preemption of state laws thus was expressly recognized as possible in the Riegle-Neal legislation itself.

Moreover, the legislative history of the Riegle-Neal Act indicates that Congress expected the OCC to apply traditional, recognized preemption standards in deciding preemption issues, which, as I have already explained, is exactly what the OCC is doing.

Finally, the Riegle-Neal Act also specifically provided that the provisions of any State law to which a branch of a national bank is subject under the Act *"shall be enforced, with respect to such branch, by the Comptroller of the Currency."* Thus, the Riegle-Neal Act is entirely consistent with the visitorial powers rule in providing that even when State law may be applicable to interstate branches of national banks, the OCC is to enforce such laws (in other words, the OCC retains exclusive visitorial authority).

4. The OCC has ample authority to adopt the preemption rule.

As mentioned previously, the OCC's authority to issue the preemption regulation comes from both 12 U.S.C. § 371 (regarding real estate lending) and § 93a (for all other activities). This statutory authority was recognized by the D.C. Circuit two decades ago in *CSBS v. Conover*.[32] In that case, the court expressly held that the Comptroller has the power under § 371 to issue a regulation that preempts aspects of state laws regarding real estate lending and has authority under § 93a more generally to issue regulations preempting State laws that are inconsistent with the activities permissible under Federal law for national banks. In the words of the court:

> It bears repeating that the entire legislative scheme is one that contemplates the operation of state law only in the absence of federal law and where such state law does not conflict with the policies of the National Banking Act. *So long as he does not authorize activities that run afoul of federal laws governing the activities of the national banks, therefore, the Comptroller has the power to preempt inconsistent state laws.*[33]

The authority under sections 93a and 371 described by the court in *CSBS v. Conover* thus amply supports the adoption of regulations providing that specified types of state laws purporting to govern as applied to national banks' activities and operations are preempted.

5. State law applies to national bank operating subsidiaries to the same extent as their parent banks; therefore, the preemption and visitorial powers rules apply to national banks and their operating subsidiaries equally.

[32] 710 F.2d 878 (D.C. Cir 1983).
[33] *Id.* at 878 (emphasis added).

As explained previously, the preemption and visitorial powers rules make no changes to the OCC's rules governing the activities of operating subsidiaries. As already set out in 12 C.F.R. §§ 5.34, 7.4006, and 34.1(b), national bank operating subsidiaries conduct their activities subject to the same terms and conditions as apply to the parent banks. Therefore, *by virtue of regulations already in place*, the rules apply equally to national banks and their operating subsidiaries.

It is important to note that the OCC's position does not implicate the corporate existence or governance rules of State corporations; it concerns the ability of those entities to conduct certain activities subject to *Federal* supervision and regulation. National bank operating subsidiaries conduct their activities pursuant to a *Federal license* under OCC regulations and Federal law, and do not need a State license to conduct activities they are authorized to conduct under a *Federal* permit. Operating subsidiaries are thus a Federally-authorized means by which national banks may conduct activities authorized under Federal law; as reflected in the OCC's rules, State laws in conflict with that authority must give way.

6. *States' ability to protect consumers will not be undermined by the OCC's positions on preemption of State laws and visitorial powers.*

It is simply not the case that consumers will be hurt by our rules. National banks and national bank operating subsidiaries are subject to extensive Federal consumer protection laws and regulations, administered and enforced by the OCC.[34] OCC examinations of national banks and national bank operating subsidiaries are conducted to ensure and enforce compliance with these laws and regulations and supplemental OCC supervisory standards.

As the OCC has made clear on a number of occasions, predatory and abusive lending practices have no place in the national banking system, and we have no evidence that national banks (or their subsidiaries) are engaged in such practices to any significant degree. Virtually all State Attorneys General have more than once expressed the view that information available to them does not show that banks and their subsidiaries are engaged in abusive or predatory lending practices. Indeed, in briefs filed in litigation involving the OTS, the State Attorneys General have acknowledged that predatory lending problems are centered in State-licensed non-depository institution lenders.

[34] Federal consumer protection laws and regulations that apply to national banks and to national bank operating subsidiaries include: the Federal Trade Commission Act; Truth in Lending Act; Home Ownership and Equity Protection Act; Fair Housing Act; Equal Credit Opportunity Act; Real Estate Settlement Procedures Act; Community Reinvestment Act; Truth in Savings Act; Electronic Fund Transfer Act; Expedited Funds Availability Act; Flood Disaster Protection Act; Home Mortgage Disclosure Act; Fair Housing Home Loan Data System; Credit Practices Rule; Fair Credit Reporting Act; Federal Privacy Laws; Fair Debt Collection Practices Act; the new OCC anti-predatory lending rules in 12 C.F.R. Parts 7 and 34; OCC rules imposing consumer protections in connection with the sales of debt cancellation and suspension agreements; OCC standards on unfair and deceptive practices (http://www.occ.treas.gov/ftp/advisory/2002-3.doc.); and OCC standards on preventing predatory and abusive practices in direct lending and brokered and purchased loan transactions (http://www.occ.treas.gov/ftp/advisory/2003-2.doc. and http://www.occ.treas.gov/ftp/advisory/2003-3.doc.).

On those limited occasions where we have found national banks to be engaged in unacceptable practices, we have taken vigorous enforcement action.[35] We are firmly committed to using our many supervisory measures and enforcement tools available to keep such practices out of the national banking system.

Of course, nothing in the OCC's preemption or visitorial powers rules prevents the States from applying State standards and taking actions against the entities they supervise and regulate. Indeed, *resources* would be deployed more efficiently to protect *more consumers* if States applied their resources to the conduct of S*tate supervised entities*, the OCC applied its resources to national banks, and State officials referred problems involving national banks that come to their attention to the OCC.

We very much regret that these legal issues are assuming the complexion of a turf battle between Federal and State authorities. I firmly believe that we have common goals, and we have tried to avoid this result by offering a cooperative, information sharing agreement regarding consumer complaints to State officials. The response to date has been disappointing, but we will continue to pursue cooperative arrangements with the States wherever possible.

V. <u>Conclusion</u>

In conclusion, Madam Chairwoman, we believe our new regulations provide benefits for national bank customers, are good for national banks, are good for our economy, and are entirely consistent with the fundamentals of the dual banking system. Perhaps most importantly, our actions also are entirely consistent with Congress's design of the national banking system, the powers and authority Congress has vested in national banks, and with legal precedent dating from the earliest years of the national banking system up to current times.

I am pleased to have had this opportunity to provide our views and respond to your concerns. Once again, thank you, Madam Chairwoman, for inviting the OCC's participation in this hearing.

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[35] For example, *see In the Matter of First Consumers National Bank, Beaverton, Oregon*, Enforcement Action 2003-100 (required restitution of annual fees and overlimit fees for credit cards); *In the Matter of Household Bank (SB), N.A., Las Vegas, Nevada*, Enforcement Action 2003-17 (required restitution regarding private label credit cards); *In the Matter of First National Bank in Brookings, Brookings, South Dakota*, Enforcement Action 2003-1 (required restitution regarding credit cards); *In the Matter of First National Bank of Marin, Las Vegas, Nevada*, Enforcement Action 2001-97 (restitution regarding credit cards); and *In the Matter of Direct Merchants Credit Card Bank, N.A., Scottsdale, Arizona*, Enforcement Action 2001-24 (restitution regarding credit cards). These orders can be found on the OCC's website within the "Popular FOIA Requests" section at http://www.occ.treas.gov/foia/foiadocs.htm.

Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Oversight and Investigations

Of the

Committee on Financial Services

United State House of Representatives

AMERICAN
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United States House of Representatives
January 28, 2004

Madame Chairwoman, I am Edward Yingling, Executive Vice President of the American Bankers Association (ABA). ABA brings together all elements of the banking community to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings institutions, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

The ABA is pleased to testify on the final rule recently issued by the Comptroller of the Currency ("OCC") clarifying the types of state laws that apply to national banks' lending and deposit-taking activities and the of role state regulators in enforcing state laws against national banks.[1] Congressional oversight in this area is certainly warranted. ABA strongly supports the OCC's rule because it provides greater certainty to national banks (particularly those that conduct business in more than one state), thus enabling greater efficiency, lower regulatory and legal costs, and enhanced delivery of financial services for bank customers. At the same time, we support the new standard designed to prevent possible predatory lending practices.

National banks operate in national credit markets, typically with a physical presence in many states. They are already subject to a comprehensive set of federal laws, including consumer protection laws. An expanding universe of differing state laws would impose substantial burdens on the conduct of their federally authorized activities. Absent preemption, the proliferation of state and local laws that would apply to those activities would inevitably lead at best to higher operating costs, and higher prices for financial services; at worst, it would lead to a reduction in available credit and fewer product

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[1] The rule amends the OCC's rules at Part 34 (real estate lending authority) and Part 7 (deposit-taking and non-real estate lending powers). Although substantively similar, the rule amends two separate provisions of the OCC's regulations because there is separate statutory authority for real estate lending. In addition, the rule imposes a new standard on all consumer lending that is intended to prevent predatory lending practices. 69 *Federal Register* 1904, (January 13, 2004).

options. ***More fundamentally, if state and local authorities are permitted to regulate the lending and deposit-taking activities of national banks, it is hard to see how we would continue to have a dual banking system.*** After all, what is more fundamental to banking than lending and taking deposits?

To a very large degree, the OCC rule does not break new ground. The areas covered in the rule have in many cases already been subject to preemption by the OCC in its rules and determinations or by the courts. In the past, these preemptive rulings by the OCC went forward generally on a case-by-case basis. That approach worked when the state and local actions that were preempted occurred infrequently. Recently, however, we have seen a proliferation of such state and local actions. Several of these ended up in the courts where preemption under the National Bank Act was upheld. We believe, therefore, that it was very important and correct of the OCC to issue this rule in order to make it clear to all parties where the line in preemption is. While most legal experts in this arena know that state and local laws that impinge on the fundamental activities of national banks violate the National Bank Act, apparently state and local officials have often proceeded despite the virtual certainty that their law or regulatory effort will be struck down by the courts as it pertains to national banks. In the meantime, national banks face the costly uncertainty as to how to proceed with the affected business. Banks (and their trade associations), the OCC, and the taxpayers of those state and local governments end up wasting considerable resources in litigation. This OCC rule will help avoid that uncertainty and litigation cost by bringing together in one place what was, in fact, occurring on a case-by-case basis in any event.

In my statement today, I would like to make four points regarding the OCC's preemption regulation:

- First, it is based on a long history of constitutional and legislative intent, affirmed by the courts, and it is consistent with actions of other regulators of federally chartered depository institutions.

- Second, preemption is necessary to preserve the dual banking system.

- Third, preemption of state laws will not diminish the protection of consumers.

- Fourth, options exist to address specific issues—such as predatory lending practices—without undermining the dual banking system.

These four points are explained in detail in the remainder of this statement.

I. The OCC's Rule is Based on a Long History of Constitutional and Legislative Intent

The OCC's preemption regulation is firmly based on laws enacted one hundred and forty years ago, during the administration of Abraham Lincoln. The Congress created the national banking system and clearly delegated to the Comptroller of the Currency the powers to regulate that system – including the power that is the basis of the new rule. The rule is firmly supported by longstanding U.S. Supreme Court analyses of conflicts between federal and state law. Over the last 140 years, the Supreme Court has consistently recognized that state laws are preempted where they:

(1) Impair the efficiency of national banks to exercise federally authorized powers;
(2) Conflict with federal law;
(3) Frustrate the purpose of the National Bank Act; or
(4) Obstruct the scope and effective exercise of unconditional national bank powers.[2]

ABA believes that there can be no doubt that the OCC's rule has correctly incorporated the Supreme Court's preemption doctrine. A listing of some of the court cases on which the OCC's rule is based is attached to this statement.

The OCC's rule clarifies that state laws that affect the way national banks conduct activities authorized under the National Bank Act are preempted. For lending, these types of state laws include those regarding licensing, terms of credit, permissible rates of interest, escrow accounts, disclosures and advertising. For deposit-taking, they include laws on disclosure, licensing, registration, abandoned and dormant accounts, checking accounts and funds availability. ***These areas are fundamental to the conduct of the banking business*** and rightly fall within the authority of federal regulators to determine the appropriate application of federal law to federally chartered depository institutions.

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[2] See, e.g., *Barnett Bank of Marion County v. Nelson*, 517 U.S. 25, 31-32 (1996); *Franklin Nat'l Bank of Franklin Square v. New York*, 347 U.S. 373, 378 (1954); and *Assn. of Banks in Ins. Inc. v. Duryee*, 270 F.3d. 397, 409 (6th Cir. 2001).

The OCC rule applies to national banks and their operating subsidiaries. These subsidiaries are limited to activities that can be conducted in the bank, and in practice, they function as a department of the bank. On the other hand, the rule does not apply to financial subsidiaries of national banks. These subsidiaries are functionally regulated. Nor does the rule apply to subsidiaries of bank holding companies, which are subject to state regulation.

Importantly, the OCC's rule does not preempt ***all*** state banking and financial services laws for national banks as some state organizations have suggested.[3] Rather, state laws that do not affect the conduct of the banking business, such as "infrastructure" laws,[4] are not subject to the preemption rule.

In addition, the OCC's determination remains subject to the notice and comment process of Section 114 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal Act") for state laws regarding community reinvestment, consumer protection, and fair lending.[5] Contrary to concerns that have been raised, the OCC's action is fully in accord with Congressional intent in Section 114 of the Riegle-Neal Act.[6] That section imposes on the OCC a process for ensuring public comment on requests for preemption of certain types of state consumer protection laws. *Importantly, that section does not impose or change the standard for preemption determinations.* Rather, Congress expressly intended that it should incorporate traditional judicial preemption analysis.[7]

Similarly, while the Gramm-Leach-Bliley Act[8] affirmed state authority to regulate insurance activities of depository institutions, it also incorporated the *Barnett* standard and broadly preempted all non-insurance state laws that "prevent or restrict" any depository institution (and their affiliates and subsidiaries) from engaging in activities authorized by the Act.[9]

[3] The OCC sought comment on whether it should "occupy the field" (*i.e.*, leave no room for any state regulation) with respect to real estate lending activities based on the broad authority Congress granted to the agency in 12 U.S.C. § 371. The OCC chose, however, to take a more conservative approach.
[4] State infrastructure laws are those laws that do not impact banking activities, *i.e.*, contract, criminal, property and local building and fire codes.
[5] Pub. L. 103-328, 108 Stat. 2338 (1994).
[6] *Id.*
[7] See, H. Report 103-651, 2d Sess. (1994) at 53. "Accordingly, the title emphasizes that a host state's laws regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches will apply to interstate branches of national banks established in the host state to the same extent as those laws apply to a branch of a state bank *except when Federal law preempts the application of the State laws to a national bank* . . ." [Emphasis added.]
[8] Pub. L. 106-102, 113 Stat. 338 (1999).
[9] Another concern that has also been raised is whether the OCC's preemption determination ignored the savings provision in the Home Owner's Equity Protection Act of 1994 ("HOEPA"). That provision, which is part of the Truth in Lending

It is important to note that the OCC's regulation does not differ fundamentally from regulations and determinations made by other regulators of federally chartered depository institutions. For example, the categories of state law preempted by the OCC are substantially identical to those already preempted by the Office of Thrift Supervision (OTS) for federally-chartered thrift institutions. In fact, the OCC rule does not go as far as the current preemptive regulations of the OTS and the National Credit Union Administration (NCUA). A comparison of the preemption regulations of the OCC, OTS and NCUA is attached to this statement.

II. The OCC's Rule is Fundamental to the Dual Banking System

The dual banking system is a simple, yet powerful concept. It consists of a state chartering and supervisory system for state banks and a federal chartering and supervisory system for national banks. Each relies on state or federal legislation to determine the activities of and regulatory policies for the respective charters. Certainly, many common features are shared by both charters. But the success of the system derives from the healthy differences that historically have driven new product innovation, helped reduce excessive regulatory costs, and enhanced the overall safety and soundness of the banking system.

Preservation of this important and unique system of regulation requires both a strong state system *and* a strong national system of chartering and regulation. Federal preemption serves as a check when states pass laws that inappropriately restrict or condition the fundamental activities or operations of federally chartered financial institutions. By contrast, the states are free to amend their laws if they believe that state-chartered institutions are at a competitive disadvantage *vis-à-vis* national banks as a result of preemption.

The areas addressed by the OCC rule – lending and deposit taking – are fundamental to the business of banking. If state laws apply to these most basic activities of national banks, and if states can examine national banks and enforce laws against them, the differences between the two systems would disappear—and so would the dual banking system. Simply put, for a strong national system to exist,

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Act ("TILA"), applies only to state laws that are inconsistent with HOEPA. Indeed, in American Bankers Association v. Lockyer, a U.S. District Court held that the TILA savings provision does not reach beyond TILA to control the preemption analysis under any other federal law. 239 F. Supp. 2d 1000, 1009 (E.D. Calif. 2002).

state and local governments must not be able to impose material restrictions on the fundamental banking activities of national banks. Thus, the OCC's rule, rather than harming the dual banking system, is necessary to preserve it.

III. The OCC's Preemption of State Laws Will Not Diminish Consumer Protection

Preemption of state laws will not diminish protections for consumers that do business with national banks. Consider the federal consumer protection laws and regulations with which national banks must comply, which include:

- Federal Trade Commission Act
- Truth in Lending Act
- Home Ownership and Equity Protection Act
- Fair Housing Act
- Equal Credit Opportunity Act
- Real Estate Settlement Procedures Act
- Community Reinvestment Act
- Truth in Savings Act
- Electronic Fund Transfer Act
- Expedited Funds Availability Act
- Flood Disaster Protection Act
- Home Mortgage Disclosure Act
- Credit Practices Rule
- Fair Credit Reporting Act
- Federal Privacy Laws
- Fair Debt Collection Practices Act
- OCC anti-predatory lending rules (Parts 7 and 34)
- OCC standards on unfair and deceptive practices
- OCC consumer protection rules for debt cancellation and suspension agreements

The OCC's preemption rule does nothing to diminish this sizable body of federal consumer protection laws. Furthermore, the OCC's rule imposes on national banks a new anti-

predatory lending standard to prevent them from making loans based on the value of the collateral rather than the borrower's ability to repay the loan, and to prohibit practices that are unfair or deceptive practices under the Federal Trade Commission Act ("FTC Act").

The OCC has demonstrated its strong commitment to protecting consumers in their dealings with national banks, as evidenced by its promulgation of comprehensive predatory lending advisory letters and vigorous enforcement of unfair or deceptive trade practices. For example, the agency has taken six enforcement actions against national banks under the FTC Act that have generated hundreds of millions of dollars in restitution to consumers. The OCC has also moved aggressively against national banks engaged in payday lending programs, requiring them to terminate relationships with payday lenders.

These enforcement actions further demonstrate that the OCC has the resources to assure compliance with consumer protection laws. The OCC employs approximately 1,900 examiners to cover 2,100 national banks. All national banks are examined at least once every 18 months, and these examinations include ***both*** safety and soundness and consumer compliance reviews. Indeed, the largest national banks have permanent examiners on site. For example, Bank of America has 40 on-site examiners. Clearly, there is no shortage of resources to assure national banks operate safely and soundly, while respecting the rights and needs of consumers. In fact, it is quite clear to us that the enforcement resources – ***both in terms of regulatory power and examination capabilities*** – are greater for the OCC with respect to national banks than the resources available to state and local authorities.

Moreover, the ***remedies*** available to the OCC are broader than those available to state and local authorities. For example, a state attorney general may order restitution only to consumers that live in his or her state. By contrast, OCC can require restitution for all of a national bank's customers regardless of where they live. Indeed, as recently observed by the Superior Court of Arizona, Maricopa County, the restitution and remedial action ordered by the OCC was "comprehensive and significantly broader in scope than that available through state court proceedings."[10]

[10] *State of Arizona v. Hispanic Air Conditioning and Heating, Inc.*, CV 2000-003625, Ruling at 27, Conclusions of Law, paragraph 50 (2003).

IV. Options Exist to Address Specific Issues without Undermining the Dual Banking System

Much of the debate over the OCC rule has been in the context of the need to address the terrible problem of predatory lending. However, we believe it would be a mistake to undermine the dual banking system in a very broad way because of concerns about an individual issue, even one as important as predatory lending, since there are other, more direct and effective ways to address the problem. As noted above, allowing state and local governments to regulate the most fundamental activities of national banks—in this case lending—would dramatically impact the dual banking system. However, that does not mean that state and local governments should not have a role in addressing any concerns that should arise with respect to predatory lending by national banks (although there has been scant evidence that banks have been a significant problem in the area of predatory lending, as pointed out in the recent court brief signed by nearly two dozen State Attorneys General).[11]

There are, in fact, at least two approaches – not mutually exclusive – to predatory lending that we believe would work well within the context of the dual banking system and without doing damage to that system. The first involves cooperation between the OCC and state and local officials; the second involves targeted federal legislation to address predatory lending practices.

While some have recently questioned the regulatory and enforcement authority and capabilities of the OCC, we believe (as outlined above) that it is quite clear that the OCC does have strong capabilities in regulation and enforcement, including the area of predatory lending. The OCC has the authority to issue regulations in this area (as evidenced by the rule being reviewed here today), has examiners that routinely examine every national bank (and permanently stationed in the larger banks), and has significant enforcement powers to stop any predatory lending practices and provide penalties and restitution.

To best serve the interests of consumers, we believe that state and local governments should work on an on-going basis with the OCC to identify any problems and recommend any changes in the regulation of national banks that may be necessary to address those problems. The OCC has indicated its strong interest in this kind of cooperation. In addition, should state and local enforcement

[11] Brief for Amicus Curiae State Attorneys General, *Nat'l Home Equity Mortgage Ass'n v. OTS*, Civil Action No. 02-2506 (GK) (D.D.C.) at 10-11.

authorities find specific situations in which national banks are engaging in unethical or illegal activities, they should forward this information directly to the OCC for action. Should such activities be discovered, we are quite confident that the OCC would take strong action against the institution and individuals involved. I am sure Members of Congress would also be interested, given the great concern about predatory lending, in using congressional oversight authority to ensure that the OCC is taking a strong stand.

We believe that this is the way the dual banking system should work. Under this approach, state and local governments would not try to regulate fundamental activities of national banks, and therefore the dual banking system would be maintained. At the same time, any problems that are discovered by state and local enforcement authorities would be addressed by the regulator with the expertise in supervising the national banking system.

A second approach, which is not inconsistent with the first, is the passage of targeted federal legislation to address predatory lending. There are a number of areas where Congress has determined that a federal approach to a given consumer protection issue is warranted, and the Congress has been able to enact appropriate legislation without undermining the dual banking system. As you know, this is the approach recently taken by the Congress with respect to the Fair Credit Reporting Act.

We do understand that in many ways real estate lending is a local issue, as real estate markets are, by and large, local. However, the huge impact of the secondary market on real estate lending is evidence that a national approach to predatory lending may be best solution. In fact, several state and local initiatives have immediately run afoul of the national secondary market, with the result that those initiatives had to be changed.

Concerns about predatory lending could be addressed through both these approaches, and we recommend that the Congress actively consider proposals for a national approach to predatory lending, such as that contained in the legislation H.R. 833, The Responsible Lending Act, introduced by Congressmen Robert Ney (R-OH), Ken Lucas (D-KY), Paul Gillmor (R-OH), and Gary Miller (R-CA).

Conclusion

In conclusion, the ABA believes that the OCC's approach to national standards for national banks and, in particular, predatory lending practices, is a measured one, grounded firmly in traditional judicial preemption doctrine. The OCC's rule preserves national standards for lending and deposit-taking by national banks and strengthens the dual banking system. It eliminates much of the uncertainty for national banks, thereby facilitating better planning and delivery of financial services. Coupled with vigorous enforcement of fair dealing and high ethical standards for national bank lending relationships with consumers, these standards for national banks will ensure that home loans remain available to all consumers and that national banks do not engage in predatory or unfair and deceptive practices.

The ABA appreciates the opportunity to provide our views on this important topic.

Attachment A
Federal Preemption Cases Involving National Banks

1870 – National Bank v. Commonwealth, 76 U.S. (9 Wall) 353. Shortly after the passage of the National Bank Act, the U.S. Supreme Court held that a Kentucky tax on bank shares was not preempted by the National Bank Act. Nonetheless, the Supreme Court stated that national banks are –

> *...exempted from State legislation, so far as legislation may interfere with, or impair their efficiency in performing the functions by which they are designed to serve...*

1896 – Davis v. Elmira Savings Bank, 161 U.S. 275. A New York State law that established preferences for creditors of an insolvent bank was found to conflict with the terms of the National Bank Act. In its opinion, the Supreme Court noted that national banks are federal instrumentalities, and that state laws that either impair their efficiency or frustrate their authority are void:

> *National banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt, by a state, to define their duties or control the conduct of their affairs is absolutely void, whenever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiencies of the agencies of the Federal government to discharge the duties, for the performance of which they were created.*

1903 – Easton v. Iowa, 188 U.S. 220. An Iowa law prohibiting the acceptance of deposits by insolvent banks was found to be incompatible with the system of regulation established by the National Bank Act. In its opinion, the Supreme Court noted that in passing the National Bank Act, Congress created a banking system independent of state legislation:

> *[The National Bank Act] has in view the erection of a system extending throughout the country, and independent, so far as powers conferred are concerned, of state legislation, which, if permitted to be applicable, might impose limitations and restrictions as various and numerous as the States.*

1923 – First Nat'l Bank of San Jose v. State of California et al, 262 U.S. 366. A California statute that provided for the transfer of dormant accounts to the state after a set period of time was found to conflict with the National Bank Act. In its opinion, the Supreme Court again referred to national banks as federal instrumentalities:

> *These banks are instrumentalities of the Federal Government. Their contracts and dealings are subject to the operation of general and undiscriminatory state laws which do not conflict with the letter of the general object and purposes of congressional legislation. But any attempt to define their duties or control the conduct of their affairs is void whenever it conflicts with the laws of the United States or frustrates the purposes of the national legislation or impairs the efficiency of the bank to discharge the duties for which it was created.*

1954 – Franklin Nat'l Bank v. New York, 347 U.S. 373. A New York law prohibiting the use of the word "savings" in advertisements by certain state and national banks was found to interfere with the enumerated authority of national banks to accept deposits. In its opinion, the Supreme Court noted that the authority of the Federal Government to regulate national banks was settled over 40 years before the passage of the National Bank Act, when the Court held that the states had no power to tax or regulate the Second National Bank of the United States:

> *Since McCulloch v. State of Maryland ... it has not been open to question that the Federal Government may constitutionally create and govern [national banks] within the states.*

1978 – Marquette Nat'l Bank of Minnesota v. First Omaha Services Corp., 439 U.S. 299. A Minnesota usury law was held not to be applicable to national banks. This decision by the U.S. Supreme Court stimulated the development of our national consumer credit system.

1982 – Fidelity Federal Savings & Loan Assn. v. de la Cuesta, 458 U.S. 141. A California law was held not to apply to a due on sale clause used by a federal thrift. While this case involved a federal thrift, the opinion issued by the U.S. Supreme Court stands for the proposition that a federal regulation has the same preemptive effect as a federal statute.

1983 – Conference of State Bank Supervisors v. Conover, 710 F.2d 878. In this case, the U.S. Court of Appeals for the District of Columbia upheld the preemptive effect of a real estate regulation issued by the OCC, citing the Supreme Court ruling in the de la Cuesta case. In so doing, the Court of Appeals emphasized the limitations of state laws on national banks:

> *It bears repeating that the entire legislative scheme is one that contemplates the operation of state law only in the absence of federal laws and where such state law does not conflict with the policies of the National Bank Act. So long as he does not authorize activities that run afoul of federal laws governing the activities of the national banks, therefore, the Comptroller has the power to preempt inconsistent state law.*

1996 – Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25. A Florida law that prohibited banks from selling insurance was held to conflict with the insurance sales powers of national banks. In its opinion, the Supreme Court stated that state laws that "prevent or significantly interfere" with the authorized powers of national banks are subject to preemption. Congress subsequently included this "prevent or significantly interfere" phrase in the insurance provisions of the Gramm-Leach-Bliley Act.

1996 – Smiley v. Citibank, 517 U.S. 735. A California law was held not to apply to a late payment fee imposed on a credit card loan by an out-of-state national bank. In this case, the U.S. Supreme Court expanded upon its earlier Marquette ruling, concluding that the provision of the National Bank Act related to interest rates also overrides state laws on late payment fees.

1999 – Bank One, Utah, N.A. v. Guttau, 190 F.3d 844 (8th Cir.). An Iowa law restricting the operation of ATMs by out-of-state banks was held to conflict with the National Bank Act. In reaching this decision, the Court of Appeals for the Eighth Circuit favorably cited a statement made by the U.S. Supreme Court in the Barnett case:

Grants of both enumerated and incidental 'powers' to national banks [are] grants of authority not normally limited by, but rather ordinarily pre-empting contrary state law.

2001 – ABIA v. Duryee, 270 F.3d 409 (6th Cir.). An Ohio law that limited the ability of national banks to sell insurance was found to infringe on the powers of national banks. Citing the Supreme Court's decision in the 1944 Anderson case, the U.S. Court of Appeals for the Sixth Circuit noted that –

Pre-emption in the area of national banks may occur even if compliance with both state and federal laws is possible where the state laws "infringe the national banking laws or impose an undue burden on the performance of the banks' functions".

2002 – Bank of America v. City and County of San Francisco, 309 F.3d 551 (9th Cir.). California municipal ordinances that prohibited banks from charging ATM fees to non-depositors were found to intrude on the powers of national banks. In doing so, the U.S. Court of Appeals for the Ninth Circuit noted that –

The National Bank Act was enacted to protect national banks against intrusive regulation by the States.

2003 – Wells Fargo Bank, N.A. v. Demetrios, 265 F.Supp. 2d 1162 (E.D. Cal.). An attempt by the State of California to license and examine a real estate subsidiary of a national bank was found to be contrary to the National Bank Act. In so holding, the U.S. Court of Appeals for the Ninth Circuit affirmed that the preemptive power of the National Bank Act runs not only to a national bank, but also to an operating subsidiary engaged in activities permissible for the parent:

Because [Wells' mortgage subsidiary] "is treated as a department or division of its parent [national bank] for regulatory purposes," the Commissioner lacks visitorial power over [the subsidiary] just as it lacks visitorial power over [the subsidiary's] national bank parent. (Quote from a Wisconsin federal district court case).

In the Wells case, the Court also cited a federal district court opinion (First Union Nat'l Bank v. Burke) to emphasize that federal preemption does not detract from the inherent regulatory powers of the states:

Under the national banking regulatory scheme, Congress does not direct the state executive to affirmatively function in any particular way, nor does the OCC's exercise of exclusive visitorial powers over national banks preclude the state statutory enactments from being applied to national banks provided they are not in conflict with and thus preempted by federal banking laws. By creating such a scheme, Congress has not seized the machinery of state government to achieve federal purposes. The relegation of regulatory and supervisory authority over federal instrumentalities to a single federal regulator does not interfere with the Commissioner's enforcement of state law against state banks, does not interfere with the state's enactment of non-preempted state banking law applicable to national banks, does not preclude the Commissioner from seeing OCC enforcement of state

> *laws, and expressly leaves available judicial remedies to compel national bank compliance with state law.*

2003 – Beneficial Nat'l Bank v. Anderson, 123 S.Ct. 2058. A state law governing claims and remedies related to usury was found to be contrary to the National Bank Act. In reaching this conclusion, the Supreme Court noted that –

> *...this Court has also recognized the special nature of federally chartered banks. Uniform rules limiting the liability of national banks and prescribing exclusive remedies for their overcharges are an integral part of a banking system that needed protection from "possible unfriendly State legislation."*

Attachment B

Proposed OCC Preemption Rules Are Patterned After Long-Standing OTS and NCUA Preemption Rules

The Office of the Comptroller of the Currency ("OCC") has proposed regulations to preempt state laws affecting the lending and deposit-taking activities of national banks and their operating subsidiaries. The OCC's proposed regulations are patterned after long-standing regulations issued by the Office of Thrift Supervision ("OTS") and the National Credit Union Administration ("NCUA").

Both OTS and NCUA have regulations that broadly preempt specific types of state lending and deposit-taking laws for federal thrifts and federal credit unions. OTS also has extended its preemption regulations to the operating subsidiaries of federal thrifts.

The NCUA regulation preempting state lending laws was adopted almost 20 years ago (see 12 C.F.R. § 701.21(b)). NCUA also has adopted a regulation that preempts state deposit-taking laws (see 12 C.F.R. 701.35(c)).

The current OTS regulation preempting state lending laws has been in effect for over 7 years, and is based upon longstanding legal opinions by both OTS and its predecessor, the Federal Home Loan Bank Board (see 12 C.F.R. §560.2). OTS also has issued a regulation that preempts state deposit-taking laws (see 12 C.F.R. § 557.12).

The following tables compare the OCC's proposed preemption regulations and the existing OTS and NCUA preemption regulations. The first table illustrates the similarities between the types of state laws preempted by the proposed OCC regulations and those preempted by the existing OTS and NCUA regulations. The second table lists the types of state laws that are ***not*** preempted by the proposed OCC regulations and the existing OTS and NCUA regulations, and shows that the proposed OCC regulation expressly preserves more state laws than the existing OTS and NCUA regulations.

Types of State Lending and Deposit-Taking Laws Preempted by the Proposed OCC Regulations and the Existing NCUA and OTS Regulations

	OCC	OTS	NCUA
Abandoned and dormant accounts	√	√	√
Aggregate amount of funds that may be lent on the security of real estate	√*		
Checking/share accounts	√	√	√
Covenants and restrictions necessary to qualify leaseholds as security property for a real estate loan	√*		
Credit reports, access to and use of	√	√	
Credit terms	√	√	√
Creditor insurance/credit enhancements/risk mitigants	√	√	
Due-on-sale clauses	√	√	√
Escrow, impound and similar accounts	√	√	
Funds availability		√	
Interest rates and fees	√	√	√
Licensing, registration, filings and reports	√	√	
Loan-to-value ratios	√*	√	√
Mandated statements and disclosure requirements	√	√	√
Mortgage origination, processing and servicing	√	√	
Repayment/disbursement	√*	√	√
Savings account orders of withdrawal	√	√	
Security property, including leaseholds	√	√	√
Special purpose savings services (deposit-taking)	√	√	

* The OCC's existing real estate lending regulation (12 C.F.R. §34) already preempts these categories of state law.

Types of State Laws *Not* Preempted by the Proposed OCC Rule and the Existing OTS and NCUA Regulations

	OCC	OTS	NCUA
Collection costs, attorneys' fees			√
Commercial		√	
Contract	√	√	
Criminal	√	√	
Debt collection	√		
Default conditions			√
Homestead (12 USC 1462(a)(f))	√	√	
Incidental effect only	√	√	
Insurance			√
Plain language requirements			√
Real Property	√	√	√
Taxation	√		
Torts	√	√	
Zoning	√		

TRANSCRIPT OF VOICE MAIL MESSAGE RECEIVED BY ASSISTANT ATTORNEY GENERAL MARK FLEISCHER ON JANUARY 7, 2004

Mr. Fleischer this is Barbara Brown-Eddy from First Horizon Home Loan Corporation, returning your call concerning the Richard Hall matter. Our Loan Number #0007047475. You mentioned that you had sent a letter to us dated December 19, 2003. I am located in Texas and I don't know if that letter was sent to our Texas location or not but it has not made it to the legal department.

I need to advise you that as an operating subsidiary of a National Bank and pursuant to an Advisory Letter from the Office of the Comptroller Currency, #2002-9, as an operating subsidiary of a National Bank we are governed by the OCC and that Advisory Letter states that any State inquiries, our response to any State inquiries with regards to an issue of any op-sub of a National Bank should be directed through the OCC and we would make any response to the OCC. Therefore, I am not at liberty to discuss this file in any detail because that is our policies and procedures pursuant to the Office of the Comptroller Guidance. So if we receive your letter, that is the response that we would give you along with the copy of the opinion and the OCC Advisory Letter. I am happy to send that to you, if you would like. But, again, we would have to respond to any inquiry that is directed through the OCC and not through a State agency. I am at 214-441-5319. Thank you. Good evening.

Congress of the United States
House of Representatives
Washington, DC 20515

April 1, 2004

The Honorable David M. Walker
Comptroller General
General Accounting Office
441 G Street, NW
Washington, D.C. 20548

Dear Comptroller General Walker:

As you may be aware, the Office of the Comptroller of Currency (OCC) finalized two rules on January 7th affecting the applicability of state consumer laws and enforcement authority to national banks. We respectfully request that the General Accounting Office investigate and examine (1) OCC conduct associated with the finalization of these rules, and (2) the impact of these rules on the dual banking system and consumer protections.

Our concerns with these regulations are both procedural and substantive in nature. The procedural concerns relate to the manner in which these rules were finalized and, specifically, to actions by the OCC which served to diminish or evade appropriate Congressional review. During the past several months, OCC officials have appeared unwilling or incapable of responding to specific questions regarding their review of publicly-filed comments on their proposal and the circumstances that led them to disregard Congressional requests to delay finalization. A chief concern of ours is that the OCC's ostensibly haphazard review of this matter tangibly undermined the Agency's ability to meet its responsibility to the public. Therefore, we are asking that the GAO review OCC's actions and procedures leading up to the decision to finalize these rules.

Additionally, we request that your office undertake a complete review of the impact of these rules on the dual banking system and efforts to protect consumers. These regulations have significant implications for both the dual banking system and consumer protections, and there are still many questions and issues that have not been addressed by the OCC. Since the regulations were implemented on Feb. 12, states are now unable to determine and enforce their own laws for national banks operating in their jurisdiction. Yet, there remain concerns that Americans will lose a layer of protection and service that has served them well.

In order to assist Congress in its oversight of the OCC, this investigation should include a review of the impact of the Agency's decisions and whether these rules establish a new paradigm of applicable law for national banks and their subsidiaries that Congress had not intended. In addition, since the rules have been implemented prior to Congressional review, we would like to know the steps the Agency has taken to implement these regulations and ensure that there are adequate resources to accommodate consumers, including education efforts for financial institutions and the general public.

Specifically, we ask the General Accounting Office to undertake a review of the OCC's recent regulations, including determining:

- How would you describe the OCC's rule making and public comment process? How has the Agency responded to criticisms of their rulemaking? Has this resulted in substantive changes to their proposed rules? Do changes need to be made to ensure that the OCC is more responsive to Congress and the American people?

- What research did the OCC conduct on the impact of their preemption on dual banking and consumer protection? Is it quantifiable evidence? Did the OCC have a comprehensive list of operating subsidiaries of national banks prior to issuing the regulations?

- Has there been, as some critics have claimed, a long-term campaign within the OCC to gain charter advantage through the use of preemption? Has the Agency coordinated legal challenges with national banks to erode Riegle-Neal provisions of applicable state laws?

- Does the preemption provided by the OCC's rules establish a new paradigm of applicable law for national banks and their subsidiaries? What is the result for consumers?

- Please explain the distinctions between a national bank, an operating subsidiary, a holding company subsidiary and a financial subsidiary? Are these new legal distinctions?

- Do the OCC's regulations expand the definition of the OCC's "visitorial" authority for national banks and operating subsidiaries? What is the impact of the new definition on state law enforcement and regulator authority? Does the OCC have sufficient staff to fully oversee all national banks and their operating subsidiaries?

- What impact will the OCC's regulations have on the dual banking system? Is there evidence that the new OCC regulations will contribute to charter conversions? What impact would the projected charter conversions have on consumers?

- What value has our federalist dual banking system contributed to the banking industry and our economy? Is there still a role for federalism in our banking system? Does Congress need to take any action to restore balance in the dual banking system?

- How the OCC has been handling consumer complaints? What the OCC has done to answer consumer questions where national and state regulations "intersect?" Have there been meaningful and measurable efforts to address consumer concerns? Will there be increased demands on the OCC's consumer complaint division? Do they have adequate resources to meet new demands?

- What will be the costs and benefits for consumers resulting from OCC preemption of state laws and law enforcement?

- How can state and federal regulators work together to find ways to preserve and improve the longstanding benefits of the dual banking system in way that enhances consumer protection and promoters growth in the financial services sector. Is legislation necessary to promote state and federal partnerships that preserve the benefits of the dual banking system?

This information will assist Congress in its continued oversight of the OCC and the Agency's recently passed regulations. We have attached additional questions and responses from the OCC from the Subcommittee's hearing on January 28th, 2004 to assist in your investigation. Please contact our offices if you have questions.

Sincerely,

Sue W. Kelly
Chairwoman
Subcommittee on Oversight and Investigations

Luis V. Gutierrez
Ranking Member
Subcommittee on Oversight and Investigations

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

February 27, 2004

The Honorable John D. Hawke, Jr.
Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Dear Comptroller Hawke:

On January 28, 2004, the Subcommittee on Oversight and Investigations held a hearing on OCC preemption issues. We intend to hold a follow-up hearing at the end of March. In preparation for that hearing, please provide the information requested below to the Committee no later than March 22.

Thank you for your attention to these matters.

Sincerely,

Sue W. Kelly
Chair
Subcommittee on Oversight and Investigations

Luis V. Gutierrez
Ranking Member
Subcommittee on Oversight and Investigations

1. How many letters did the OCC receive during the comment period, and what was the nature of these letters? How many Members of Congress wrote the OCC during the rulemaking process, and what was the nature of these comments? What is the total number of letters the OCC received in each rule the Agency passed in the last 3 years, and the nature of those letters?

2. What compelled the OCC to move forward with such urgency when Congress was adjourned, and are there other occasions when the OCC finalized rules when Congress was in recess? Why did the OCC refuse to delay the rules until Congress had a chance to review them, which Congress requested? What are the alternatives the OCC could have taken, including a moratorium on state laws until Congress could investigate the issue? Did the OCC consider grandfathering laws that states have already passed, or allowing the OCC standard to serve as a 'floor', which would permit states to address more local concerns and needs? Did pending cases in the courts factor in to the urgency that required that OCC to finalize the regulation through before Members returned from recess?

3. The regulations indicate that state laws are preempted for national banks if "they obstruct, impair or condition a national bank's ability to fully exercise the powers authorized to it under Federal law, including the content of those activities and the manner in which and standards whereby they are conducted." Doesn't this mean that any law that affects in any way the way a bank conducts its lending activities, or its depository activities, will be preempted?

4. Is it the OCC's opinion that Congress has authorized the OCC to prevent States from applying its own laws to corporations created under that individual State's laws? Why did the OCC choose to scale back the final regulations from their original proposal, and on what grounds does the OCC believe it has the legal authority to "occupy the field" of real estate lending for national banks? Deputy Comptroller Williams testified that state laws regarding certain subjects such as civil rights would not be preempted. Given that the OCC has progressively enlarged the scope of its preemption over the years, are you choosing not to preempt civil rights laws at this time because you do not wish to exercise authority in that area, or is it because you lack the authority to do so? What else do you feel you have the authority to preempt but are choosing not to at this time? Where does your preemption authority end?

5. It is have been stated in several contexts that state laws prohibiting unfair and deceptive acts and practices will not be preempted. North Carolina, for example, has a very strong law against unfair and deceptive acts and practices which has been held applicable to the unfair trade practices of national banks. Would you allow the application of that law to the unfair activities of a national bank doing business in that state?

6. How do you propose to enforce unfair and deceptive practices violations, when the OCC has no authority to define unfair acts or practices? Isn't is true that when targeting aggressive payday loan programs, you used the basis of safety and soundness to exercise authority? While many believe that payday and other predatory loan activities are inherently unsafe, unsound and inappropriate for financial institutions, it is clear that many vile products could be seen as safe and sound because they are profitable, even though they may be unfair and deceptive. How do you plan to resolve this contradiction and exercise enforcement in these areas?

7. Please provide a copy of the OCC's amicus brief and other relevant documents in the case of Fleet Boston in Rhode Island regarding Rhode Island state law on unfair and deceptive acts and practices and any similar briefs the OCC has filed in connection with cases entailing private consumer litigation in which the relevant state agency is not a party.

8. In previous testimony, there is an attempt to justify the timing and necessity of the OCC's action by claiming that the variety of state predatory lending laws is creating too much uncertainty in the secondary markets and sounding the death knell for the extension of credit in high cost loan situations. However, this argument for preemption seems a little disingenuous because the vast majority of the rating agencies and secondary purchasers you cite as examples in your testimony also will not rate or buy loans under HOEPA, the federal law that governs high cost loans. Most of the state laws you cite are very similar to HOEPA, although some extend protection a little farther. Generally, Salomon Brothers and a few other specialists are the only ones who participate in this market. However, it appears that the market has found solutions to the issue of open ended liability in New York, for example, by requiring warranties and representations. And there are some software programs that will allow potential purchasers of these loans to screen for (and price for) any state law issues. Does the OCC plan to address this issue, namely that several companies have already developed compliance software for these state laws, and guarantee the systems' ability to identify loans violating state predatory lending laws? It seems that this problem you refer to may have a number of solutions. And the very issue that creates the perceived problem is one of federal law. Are you intending to fail to enforce HOEPA in order to create uniformity for the secondary markets?

9. The proposed regulations seem to indicate that the OCC will no longer engage in the preemption procedure that was established by Congress in Riegle-Neal. Will the OCC continue to provide notice and a comment period when it preempts state consumer protection laws?

10. The OCC has a history of inconsistency with regard to its preemption authority and seems to be engaging in revisionist history.

- In 1982, the OCC issued a regulation that listed five categories of state law that do not apply to real estate lending by national banks (relating to the loan to value ratio, the repayment schedule, the term, maximum loan amount and covenants and restrictions necessary to qualify a leasehold as an acceptable security).

- In a 1992 letter, the OCC stated, "The states also concurrently regulate real estate lending. The OCC's regulation provided for limited preemption of such state statutes in the case of national banks.

In a 2002 case, *Bank of America vs. City and County of San Francisco,* the OCC recognized state law application to national banks in a number of fields including unfair and deceptive acts.

How do you resolve these past statements with your current actions? Similarly, the OCC's website currently states that "The OCC does not have a mandate to engage in consumer advocacy, but it is responsible for ensuring the safety and soundness of the national banking system." Do you envision that this mandate will change, given this new regulation preempting state enforcement? If not, will the OCC provide another mechanism to enforce consumer claims against banks?

11. We have previously requested copies of all testimony by the OCC in connection with the Riegle Neal legislation. Please provide that data as soon as possible.

12. Please provide a list of cases and relevant details where the OCC has sued institutions for predatory lending, fraud and any other consumer law violations as well as the amount of damages collected by the OCC and by consumers.

13. What steps has the OCC taken to implement these regulations and ensure that the agency has the resources to fulfill its newly expanded responsibilities? Does the OCC believe that these regulations adequately address the issue of predatory lending, considering the Agency's assertion that national banks do not partake in this practice? Does this create an un-level playing field, and does more need to be done?

14. Please provide the following information for the past three years, broken down by year, segregated by State location of the subsidiary (if applicable):

- Total number of national bank operating subsidiaries under the supervisory jurisdiction of the OCC
- List of the operating subsidiaries and their respective type of business which are under the supervision of the OCC
- Total number of operating subsidiary examinations and the total number of consumer complaint investigations completed by the OCC
- List the total number of enforcement actions (by type) against all banks and operating subsidiaries under the OCC's supervision
- Total amount of consumer restitution ordered from OCC investigations of all national banks and operating subsidiaries
- Number of written and telephone inquiries and complaints the OCC has received and processed regarding operating subsidiaries and banks under the supervision of the OCC
- Average response time for these telephone and written inquiries.
- Average amount of time spent to resolve both consumer complaints and inquiries on operating subsidiaries and banks under the supervision of the OCC
- Percentage of complaints resolved in the consumer's favor

- Total number and location of OCC staff exclusively engaged in processing of complaints and inquiries from consumers and, separately, the number and location of OCC staff primarily engaged in monitoring and enforcing compliance with federal and state consumer protection laws by national banks and national bank operating subsidiaries. Also, please provide the grade level and location of these staff members. How many of these are attorneys trained in consumer law? (If there is no staff exclusively involved in this process, please give the average amount of time staff devotes to investigate consumer complaints and inquiries regarding operating subsidiaries.)
- Please indicate the outreach the OCC is doing to educate the general public and ensure that people know where file complaints and settle disputes.
- Does OCC staff responsible for consumer compliance review for compliance with both Federal and State laws and regulations? If yes, please provide a sample of responses from OCC regarding a state issue.
- All correspondence to consumers regarding compliance with a state consumer protection law or regulation that the OCC has preempted.
- A copy of any section of an OCC manual (compliance, safety and soundness, or complaint) that reference a procedure for investigating an operating subsidiary
- The number of examiners that are exclusively trained for and examine operating subsidiaries
- Total number of examiners and, as a subset, total number of compliance examiners
- Total number of operating subsidiaries (detailed by asset category) that were not examined during an OCC examination of the parent national bank.

OCC RESPONSES TO QUESTIONS FROM
CHAIRWOMAN KELLY AND RANKING MEMBER GUTIERREZ

1. How many letters did the OCC receive during the comment period, and what was the nature of these letters? How many Members of Congress wrote the OCC during the rulemaking process, and what was the nature of these comments? What is the total number of letters the OCC received in each rule the Agency passed in the last 3 years, and the nature of those letters?

Comments on the preemption rule

The OCC received 2,706 comment letters on the proposed preemption rule. As we described in the preamble to the final rule,[1] the vast majority – approximately 85% – of the opposing comments came from realtors and others representing the real estate industry, who expressed identical concerns about the possibility that national banks' *financial subsidiaries* would be permitted to engage in real estate brokerage activities and that, if that power were authorized, the proposal would permit them to do so without complying with state real estate brokerage licensing laws.

The rule, however, has absolutely no effect on real estate brokerage. The rule neither enhances the ability of national banks to engage in real estate brokerage nor preempts state laws pertaining to real estate brokerage. National banks and their operating subsidiaries are not authorized to engage in the real estate brokerage business. The rule addresses certain types of state laws concerning real estate *lending*, not brokerage. Suggestions that the rule affects real estate brokerage activities are based on speculation about a combination of circumstances, neither of which exist: 1) authorization of national banks and their operating subsidiaries to conduct real estate brokerage (they are not so authorized), and 2) an OCC rule preempting state real estate broker laws (there is no such rule).[2]

Forty Members of Congress submitted comments on the preemption rulemaking, or forwarded letters from constituents and state officials, that echoed various concerns regarding the impact of the proposal, particularly on state and local efforts to combat predatory lending. A number of Members suggested that the OCC defer or withdraw the proposal until Congress could undertake

[1] The preamble to the final rule also describes the number and nature of the comments we received on the proposal. *See* 69 Fed. Reg. 1904, 1906-07 (January 13, 2004).

[2] Concerns about preemption of state real estate brokerage laws appear to be prompted not by the regulation the OCC has issued, but by the possibility that national banks could, in the future, be permitted to engage in real estate brokerage activities. Several years ago, the Board of Governors of the Federal Reserve System (Board) and the Department of the Treasury (Treasury) issued a proposal addressing whether real estate brokerage should be considered an activity that is "financial in nature," and thus permissible for financial holding companies and bank *financial subsidiaries*. *See* 66 Fed. Reg. 307 (January 3, 2001). The OCC's preemption rule would not apply to real estate brokerage activities even if the joint proposal were ever to be finalized. The rule does not apply to national bank financial subsidiaries. Thus its provisions do not preempt *any* state laws – including state real estate brokerage laws – for financial subsidiaries. Moreover, the preemption rule could not apply even if the Board-Treasury proposal were finalized because the applicability of state law to financial subsidiaries is determined under a different standard, that is, the standard that Congress expressly established in Section 104 of the Gramm-Leach-Bliley Act. 15 U.S.C. § 6701(d)(1).

further review of the issues involved. Our response to Question 2 contains a detailed discussion regarding the timing of issuance of the final rules.

In addition to these comments, the OCC received comments from community and consumer advocates. These commenters argued that the OCC should not adopt further regulations preempting state law and, in particular, should not adopt in the final rule an "occupation of the field" preemption standard for national banks' real estate lending activities. The community and consumer advocates also asserted that the proposed "obstruct, in whole or in part" preemption standard is inconsistent with, and a lowering of, the preemption standards articulated by the U.S. Supreme Court. Whatever the standard, the community and consumer advocates expressed concern that preemption would allow national banks to escape some state tort, contract, debt collection, zoning, property transfer, and criminal laws, and would expose consumers to widespread predatory and abusive practices by national banks. These commenters asserted that the OCC's proposed anti-predatory lending standard was insufficient and urged the OCC to further strengthen consumer protections in parts 7 and 34, including prohibiting specific practices characterized as unfair or deceptive.

State banking regulators, the Conference of State Bank Supervisors, the National Conference of State Legislators, individual state legislators, the National Association of Attorneys General, and individual state attorneys general questioned the legal basis of the proposal and argued that the OCC lacks authority to adopt it. These commenters, like the community and consumer advocates, also challenged the OCC's authority to adopt in the final rule either a "field occupation" preemption standard or the proposed "obstruct, in whole or in part" standard. These commenters raised concerns about the effect of the proposal, if adopted, on the dual banking system, and its impact on what they assert is the states' authority to apply and enforce consumer protection laws against national banks, and particularly against national banks' operating subsidiaries.

Finally, national banks, other financial institutions, and industry groups supported the proposal. Many of these commenters argued that Congress has occupied the fields of deposit-taking and lending in the context of national banks and urged the OCC to adopt a final rule reflecting an extensive occupation of the field approach. These commenters concluded that various provisions of the National Bank Act establish broad statutory authority for the activities and regulation of national banks, and that these provisions suggest strongly that Congress did in fact intend to occupy the fields in question. In addition to these express grants of authority, the commenters noted that national banks may, under 12 U.S.C. 24(Seventh), "exercise . . . all such incidental powers as shall be necessary to carry on the business of banking," and that this provision has been broadly construed by the Supreme Court.[3] These commenters concluded that this broad grant of Federal powers, coupled with equally broad grants of rulemaking authority to the OCC,[4] effectively occupy the field of national bank regulation.

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[3] *See, e.g., NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 258 n. 2 (1995).

[4] *See, e.g.*, 12 U.S.C. § 93a.

Many of the supporting commenters also urged the adoption of the proposal for the reasons set forth in its preamble to the proposal. These commenters agreed with the OCC's assertion in the proposal's preamble that banks with customers in more than one state "face uncertain compliance risks and substantial additional compliance burdens and expense that, for practical purposes, materially impact their ability to offer particular products and services."[5] The commenters stated that, in effect, a national bank must often craft different products or services (with associated procedures and policies, and their attendant additional costs) for each state in which it does business, or elect not to provide all of its products or services (to the detriment of consumers) in one or more states. These commenters believed that the proposal, if adopted, would offer much-needed clarification of when state law does or does not apply to the activities of a national bank and its operating subsidiaries. Such clarity, these commenters argued, is critical to helping national banks maintain and expand provision of financial services. Without such clarity, these commenters assert, the burdens and costs, and uncertain liabilities arising under a myriad of state and local laws, result in a significant diversion of the resources that national banks otherwise can use to provide services to customers nationwide, and are a significant deterrent to their willingness and ability to offer certain products and services in certain markets.

Comments on the Visitorial Powers Rule

The OCC received 53 comments on the visitorial powers rulemaking, which amended the OCC's existing visitorial powers rule to clarify issues related to the scope of the OCC's visitorial powers. These commenters included national banks, an operating subsidiary of a national bank, bank holding companies, banking trade associations, bank membership organizations, a community group association, non-profit consumer groups, a state bank supervisors' association, state bank supervisors' offices, a securities administrators' membership organization, and a law enforcement association.

The OCC did not receive any comments directly on the visitorial powers proposal from Members of Congress. However, a number of Members forwarded correspondence from state officials expressing concerns regarding the visitorial powers proposal's impact on state enforcement of applicable state laws and the sufficiency of the OCC's resources. In addition, a few Members submitted comments on the preemption proposal that also echoed these concerns.

Many commenters supported the proposal, noting that the clarification of the visitorial powers regulations would be helpful. One commenter said that subjecting national banks' Federally authorized activities to state regulation would be inconsistent with the purposes of the National Bank Act. Others noted that additional layers of state supervision would have the effect of making the operations of national banks less efficient and more costly. Commenters also stated that they supported the proposal's clarification of the "courts of justice" exception.

We also received a number of comments that opposed the proposal. These commenters advanced four principal points: first, that the visitorial powers amendments are inconsistent with the fundamental tenets of the dual banking system, pursuant to which national banks are subject to state regulation; second, that the amendments are inconsistent with the presumptive applicability of state law to national banks, as provided by the Riegle-Neal Interstate Banking

[5] 68 Fed. Reg. 46119, 46120 (August 5, 2003).

and Branching Efficiency Act of 1994 (the Riegle-Neal Act)[6]; third, that the OCC's visitorial power over national banks is not exclusive; and, finally, that the OCC lacks authority to prevent states from exercising visitorial powers over national bank operating subsidiaries.

Comments on OCC rulemakings during the past three years

We have attached a chart that lists the rulemakings the OCC has completed during the last three years, together with the *Federal Register* citation for each final rule and a brief description of the comments we received. Fuller descriptions of the comments on each rule are included in the preambles.

[6] Pub. L. 103-328, 108 Stat. 2338 (Sept. 29, 1994).

2. What compelled the OCC to move forward with such urgency when Congress was adjourned, and are there other occasions when the OCC finalized rules when Congress was in recess? Why did the OCC refuse to delay the rules until Congress had a chance to review them, which Congress requested? What are the alternatives the OCC could have taken, including a moratorium on state laws until Congress could investigate the issue? Did the OCC consider grandfathering laws that states have already passed, or allowing the OCC standard to serve as a "floor," which would permit states to address more local concerns and needs? Did pending cases in the courts factor in to the urgency that required that OCC to finalize the regulation through before Members returned from recess?

Timing of the final rules

We issued our regulation when we did based on several factors, including the scope of the regulation we ultimately determined to adopt and the escalating number of preemption questions that were being raised. Pending litigation was not a factor in the timing of our adoption of the rules, nor was there any desire to try to avoid responding to any Congressional inquiries and concerns, which we had done during, and even before, the comment process. We ultimately concluded that taking action, following an open and inclusive comment process, which included Members of Congress and their staffs, was both respectful of the role of Congress and the course most consistent with our responsibilities as supervisors of the national banking system.

We reached this conclusion for several related reasons.[7] First, the laws under which we acted exist today, and the principles incorporated in our preemption regulation and in the clarification of our visitorial powers rule are not new. The new rules are entirely consistent with *existing* law, namely, the powers Congress has granted national banks – within the past decade and dating back to the original provisions of the National Bank Act. To characterize these regulations as dramatic new standards is simply incorrect. The listed types of laws either already are preempted under longstanding, pre-existing OCC regulations, have been found to be preempted in OCC preemption opinions, have been found to be preempted by the courts, or have been determined to be preempted with respect to Federal thrifts by the Federal thrift supervisor, the OTS. Thus, substantial precedent existed that the types of laws we ultimately determined to be preempted interfered impermissibly with the Federal authority of Federally-chartered institutions to engage in lending and deposit-taking.

Second, the continuing uncertainty about the applicability of state laws had already affected national banks' ability to lend in certain markets and to access the secondary market, a curtailment of their business that is not only inconsistent with their Federally authorized powers but also one that has the potential to adversely affect credit availability as well as interfere with banks' ability to structure their balance sheet to enhance safety and soundness.

[7] A more detailed description of the factors we considered in issuing the final preemption and visitorial powers rules appears in the written statement that the OCC submitted in connection with the hearing on those rules recently held by the Subcommittee on Oversight and Investigations. *See* Testimony of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency, Before the Subcommittee on Oversight and Investigations of the Committee on Financial Services of the U.S. House of Representatives (January 28, 2004), at pp. 10-15 (Williams Testimony).

The trend at the state and local levels toward enacting legislation that seeks to impose costly and inconsistent compliance burdens on banks has accelerated. These laws, many with laudable goals, nonetheless curtail national banks' ability to conduct operations to the full extent authorized by Federal law and disrupt crucial credit delivery systems.

For example, in recent years, various states and localities have enacted predatory lending laws, each employing a combination of standards that differs in some respects from the others, but each typically singling out loan product features and either barring loans with those features or imposing requirements that make it impractically costly for lenders to offer them. These laws have real, practical, daily consequences. They have unsettled mortgage markets, reduced the availability of legitimate subprime loans to some consumers, increased regulatory burden, added operational costs, and created unpredictable standards of operation and uncertain risk exposures. Additional detail about the effects of these laws on national banks' ability to exercise their Federally authorized real estate lending powers is provided in our answer to Question 8, as well as in the written statement we provided to the Subcommittee in connection with its January 28, 2004, hearing on preemption.[8]

We fully agree that predatory and abusive practices should be promptly addressed where they arise. However, our approach is to focus on preventing those *practices,* not on banning or restricting specified loan products or terms in the absence of evidence of abusive, predatory, unfair or deceptive practices. Generally, state and local predatory lending laws that seek to control *products* and *product* terms, rather than focus on unacceptable *practices* have created uncertainties that adversely affect banks' ability to access the secondary market for legitimate, risk-priced mortgage loans. The material, practical significance of this result is to constrict the availability of credit in certain segments of the market.[9]

A third reason for issuing our regulations was to avoid delaying the implementation of the anti-predatory lending standards incorporated in the new preemption rule. Our preemption rule contains two new provisions that expressly prohibit abusive or predatory lending practices by national banks or their operating subsidiaries. The rule prohibits national banks from making any consumer loan based predominantly on the foreclosure or liquidation value of a borrower's collateral, rather than on the borrower's ability to repay the loan according to its terms. This anti-predatory lending standard applies uniformly to all consumer lending activities of national banks and their operating subsidiaries, regardless of the location from which those activities are conducted or where customers reside. This standard strikes at the heart of predatory lending, namely lending practices that effectively swindle a homeowner out of his or her property.

[8] *See* Williams Testimony at pp. 10-15.

[9] When a bank is able to sell a loan on a cost-effective basis to Fannie Mae or Freddie Mac, or obtains a rating for a pool of loans that it "securitizes" and sells to investors, the bank is able to liquify its loans and redeploy capital to make additional loans available. If Fannie or Freddie are unwilling to purchase loans made in jurisdictions with specialized predatory lending restrictions and potential liabilities, or if they impose additional costs in return for their willingness to buy such loans, the funds banks have available to make additional credit available are diminished. Similarly, if a bank is unable to obtain a rating from Standard and Poors', Moody's Investors Services, or Fitch Ratings, it will not be able to securitize its loans on a cost effective basis and reallocate capital to make additional credit available. In other words, localized and State-based restrictions on loan terms substantially affect the marketability of such loans, and that, in turn, affects overall credit availability to credit-worthy consumers.

Our preemption rule also provides that, in connection with *any* type of lending, national banks and their operating subsidiaries shall not engage in unfair and deceptive practices within the meaning of Section 5 of the Federal Trade Commission Act (FTC Act), which prohibits "unfair or deceptive acts or practices" in interstate commerce. Although we do not have the statutory authority to define particular acts or practices as "unfair" or "deceptive" under the FTC Act, we added an express reference to Section 5 to our rule in response to commenters who urged us to affirm that the principles of the Act apply to national banks. We viewed this addition as particularly appropriate in light of the fact that the OCC pioneered the use of Section 5 as a basis for enforcement actions against banks that have engaged in such conduct, and have obtained substantial restitution for customers as a result.

These new standards are comprehensive and they apply nationwide, to all national banks and their operating subsidiaries. They apply strong protections for national bank customers in every state – including the many states that do not have their own anti-predatory lending standards. The addition of these standards to our lending rules materially *reinforces* national banks' obligation to treat their customers fairly and operate pursuant to the highest standards of integrity.

Finally, our exercise of rulemaking authority was an open, broadly inclusive, and deliberative process in which we informally sought views from a number of perspectives even before proceeding with our preemption proposal. Recognizing that, in today's environment, the ability of national banks to operate under consistent, uniform national standards will be a crucial factor in their business future, the OCC began in 2002 discussing with consumer groups, members of Congress and their staffs, and industry groups the need for regulations to codify well-established preemption precedents and clarify the statute governing the OCC's exclusive visitorial powers. We have been completely open about the issues that concerned us, and the potential actions that we might take. The actions that we ultimately determined to take were not dramatic departures from existing precedent; moreover they were the product of an extended and highly inclusive formal rulemaking process that was fully cognizant of the interest and role of Congress.

Attached is a chart showing OCC final rules issued during Congressional recess dates for the years 2001 through 2003.

Alternatives to the rule

The alternatives suggested in Question 2 appear to be based on the premise that, had the OCC not finalized its preemption regulation, we could have preserved a *status quo* under which some or all state anti-predatory lending laws would have applied to national banks. That premise is incorrect for two reasons. First, some types of state anti-predatory lending provisions were already preempted by operation of our existing regulations. Prior to its amendment in January, our real estate lending regulation already listed several types of state law provisions that did not apply to national banks. We had previously concluded that that regulation preempted some

provisions of a state anti-predatory lending law.[10] The same result would have occurred for comparable provisions of other states' laws.

Second, action by the OCC is not the exclusive means by which state laws may be found to be preempted. National banks may – and regularly do – challenge the applicability of state law by litigating the issue in Federal court. Very often, these challenges have succeeded. This, in fact, is the way that preemption jurisprudence in the national bank context has developed. It is likely, therefore, that one or more national banks seeking to lend in jurisdictions with anti-predatory lending laws would have brought suit asserting that those laws do not apply. Study of over 130 years of U.S. Supreme Court precedents indicates a high probability that a national bank would prevail in cases involving the types of state laws that are covered by our regulation.

[10] *See* Determination and Order in the Matter of National City Bank, National City Bank of Indiana, and Their Operating Subsidiaries, 68 Fed. Reg. 46264 (August 5, 2003) (concluding the provisions of the Georgia Fair Lending Act were preempted).

3. The regulations indicate that state laws are preempted for national banks if "they obstruct, impair or condition a national bank's ability to fully exercise the powers authorized to it under Federal law, including the content of those activities and the manner in which and standards whereby they are conducted." Doesn't this mean that any law that affects in any way the way a bank conducts its lending activities, or its depository activities, will be preempted?

No. It is important to understand how the regulation works in order to appreciate its true scope and impact. Unfortunately, some characterizations of the rule have misunderstood both.

First, the regulation only preempts the types of laws that are listed in the rule. They are laws that are already preempted under long-standing, preexisting OCC regulations, that have been found to be preempted in OCC preemption determinations, that have been found to be preempted by the courts, or that have been determined to be preempted for Federal thrifts by the OTS. They are, in other words, types of laws for which substantial precedent exists recognizing the interference they pose to the ability of Federally-chartered institutions to operate under uniform Federal standards. We did not take the position that the rule "occupies the field" of lending and deposit-taking for national banks.

Thus, the rule does not preempt laws of general applicability that form the legal infrastructure for conducting a banking or other business. Examples of laws that are not preempted are also identified in the preemption rule and include state laws on contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes, and torts. The rule also does not disturb the status quo concerning preemption of state escheat and unclaimed property laws; rather it reaffirms that preemption does not occur for those types of laws described in the Supreme Court's *Anderson National Bank v. Luckett* decision.[11] In addition, any other law that only incidentally affects national banks' exercise of their Federally authorized powers to lend, take deposits, and engage in other Federally authorized activities would not be preempted under the final rule. In particular, as set forth in our responses to Questions 4 and 5, state anti-discrimination laws and state laws that prohibit unfair and deceptive practices would not be preempted under the new rules.

Second, the rule contains the general statement that state laws do not apply to national banks if they "obstruct, impair or condition" a national bank's ability to fully exercise its Federally granted powers. This is a summary distillation of general principles of preemption that have been articulated in cases decided by the Supreme Court; it does not preempt any particular state law. We will continue to evaluate the application of types of state laws, not listed in the rule, on a case-by-case basis, as we did before, under judicially-established standards of Federal preemption.

[11] *See* 321 U.S. 233 (1944).

4. Is it the OCC's position that Congress has authorized the OCC to prevent States from applying its own laws to corporations created under that individual State's laws? Why did the OCC choose to scale back the final regulations from their original proposal, and on what grounds does the OCC believe it has the legal authority to "occupy the field" of real estate lending for national banks? Deputy Comptroller Williams testified that state laws regarding certain subjects such as civil rights would not be preempted. Given that the OCC has progressively enlarged the scope of its preemption over the years, are you choosing not to preempt civil rights laws at this time because you do not wish to exercise authority in that area, or is it because you lack the authority to do so? What else do you feel you have the authority to preempt but are choosing not to at this time? Where does your preemption authority end?

State enforcement of state laws against national bank operating subsidiaries

Operating subsidiaries are Federally authorized means through which national banks can conduct business. National banks conduct authorized activities through operating subsidiaries pursuant to a Federal license under OCC regulations and Federal law, and it is our position that they do not need a state license to conduct activities they are authorized to conduct under a Federal permit. As set out in the OCC's regulations, at 12 C.F.R. §§ 5.34, 7.4006, and 34.1(b), national bank operating subsidiaries conduct these activities subject to the same terms and conditions – including the applicability of state law – as apply to their parent banks, except where Federal law provides otherwise (as is the case, for example, with respect to the functional regulation of insurance and securities subsidiaries). The only court cases to decide the issue thus far have held that the OCC's exclusive visitorial authority – including the authority to enforce compliance with applicable law – extends to operating subsidiaries.[12]

It is important to note that our amendments to the OCC's visitorial powers rule make clear that or visitorial authority is exclusive with respect to the "content and conduct" of activities authorized for national banks – and, thus, for their operating subsidiaries – under Federal law.[13] Thus, our rule does not implicate the corporate existence or governance rules of state corporations; the issue is what regulator supervises and regulates the activities national banks are authorized by Federal law to conduct through subsidiaries, when the subsidiary is engaged in Federally authorized banking activities.

Occupation of the field

The OCC has ample authority to provide, by regulation, that types of state laws are not applicable to national banks. A Federal statute, 12 U.S.C. § 93a, grants the OCC comprehensive rulemaking authority to further its responsibilities, stating that –

[12] *See Wells Fargo Bank, N.A. v. Boutris*, 265 F. Supp. 2d 1162 (E.D. Cal. 2003) and *National City Bank of Indiana v. Boutris*, 2003 WL 21536818 (E.D. Cal. July 2, 2003). In addition, we note that there are two cases pending that involve the OCC's exclusive visitorial power over national bank operating subsidiaries. *See Wachovia Bank, N.A. v. Burke*, Civ. Act. No. 3:03CV0738 JCH (D. Conn.) and *Wachovia Bank, N.A. v. Watters*, Civil Action No. 5:03CV0105 (W.D. MI).

[13] 69 Fed. Reg. at 1904 (revised § 7.4000(a)(3)).

> Except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to another regulatory agency, the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office . . . .[14]

Under 12 U.S.C. § 371, the OCC has the additional and specific authority to establish the "restrictions and requirements" that govern national banks' real estate lending activities. In *Conference of State Bank Supervisors v. Conover*,[15] the D.C. Circuit expressly held that the OCC has the power under section 371 to issue a regulation that preempts aspects of state laws concerning real estate lending and has authority under section 93a to issue regulations preempting state laws that are inconsistent with the activities permissible under Federal law for national banks.

We noted in the preamble to the preemption proposal that the nature and scope of the statutory authority provided by section 371 may enable the OCC to "occupy the field" of the regulation of real estate lending activities. We invited comment on whether our regulations, like those of the OTS,[16] should state explicitly that Federal law occupies the field of real estate lending.

Upon further consideration of that issue and careful review of comments submitted pertaining to this point, we concluded in the final rule, as the Supreme Court has recognized, that the effect of labeling of this nature is largely immaterial in the particular circumstances presented. Thus, we declined to adopt the suggestion of some commenters that we declare that these regulations "occupy the field" of national banks' real estate lending, other lending, and deposit-taking activities. We relied on our authority under both 12 U.S.C. §§ 93a and 371 to address specific types of state laws, and, as we explained in the preamble to the final rule, to the extent that an issue arises concerning the application of a state law not specifically addressed in the final regulation, we retain the ability to resolve those questions on a case-by-case basis.

State anti-discrimination laws

State anti-discrimination laws are not preempted by the regulation. The rule preempts only those types of state laws pertaining to making loans and taking deposits that appear on the lists contained in the rule. Anti-discrimination laws are on neither list; thus, they are not preempted by the rule. Any question about the applicability of a particular anti-discrimination law would be dealt with on a case-by-case basis, applying the "obstruct, impair, or condition" analysis, which was intended to distill, and will be applied consistent with, established judicial tests of preemption. Thus, the standards applicable for determining preemption of a state anti-discrimination law are not changed by the new rule. Under those standards, a law generally understood to be an "anti-discrimination" law would not be preempted.[17]

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[14] 12 U.S.C. § 93a.

[15] 710 F.2d 878 (D.C. Cir. 1983).

[16] 12 C.F.R. § 560.2.

[17] *E.g.*, laws that prohibit lenders from discriminating on the basis of race, religion, ethnicity, gender, sexual orientation, disability, or the like.

Scope of preemption authority

As mentioned previously, the OCC's authority to issue the preemption regulation comes from both 12 U.S.C. § 371 (regarding real estate lending) and § 93a (for all activities). As we have mentioned, this authority was recognized by the D.C. Circuit in 1983 in the *Conover* case. In that case, the court described the scope of the OCC's preemption authority as follows:

> It bears repeating that the entire legislative scheme is one that contemplates the operation of state law only in the absence of federal law and where such state law does not conflict with the policies of the National Banking Act. *So long as he does not authorize activities that run afoul of federal laws governing the activities of the national banks, therefore, the Comptroller has the power to preempt inconsistent state laws.*[18]

The authority under sections 93a and 371 described by the court in *CSBS v. Conover* amply supports the adoption of regulations providing that specified types of state laws purporting to govern and curtail national banks' lending and deposit-taking activities are preempted.

[18] *Conover*, 710 F.2d at 885 (emphasis added).

5. It has been stated in several contexts that state laws prohibiting unfair and deceptive acts and practices will not be preempted. North Carolina, for example, has a very strong law against unfair and deceptive acts and practices which has been held applicable to the unfair trade practices of national banks. Would you allow the application of that law to the unfair activities of a national bank doing business in that state?

State laws that prohibit unfair and deceptive practices do not obstruct, impair or inappropriately condition the ability of national banks to engage in lending, deposit-taking and other authorized activities, thus, they would not be preempted under well-recognized judicial precedents. The OCC has recognized the applicability of this type of state law to national banks, and has enforced such laws against national banks. For example, in *In the Matter of Providian Nat'l Bank, Tilton, New Hampshire,*[19] the OCC required payment by a national bank in excess of $300 million and imposed numerous conditions on the conduct of future business pursuant to the FTC Act and the California unfair and deceptive trade practices statute.

It is necessary, however, to look past the title of a particular state law to the substance of the law. For example, a statute with a "fair lending" or "unfair practices" title may in fact prohibit specific loan terms, or limit the ability of lenders to offer loans with specific features. In such a case, the law would be preempted because it attempts to impose specific limits on the Federal authority of national banks to make loans.

[19] Consent Order No. 2000-53 (June 28, 2000) available at the OCC's website in the "Popular FOIA Requests" section at www.occ.treas.gov/foia/foiadocs.htm.

6. How do you propose to enforce unfair and deceptive practices violations, when the OCC has no authority to define unfair acts or practices? Isn't it true that when targeting aggressive payday loan programs, you used the basis of safety and soundness to exercise authority? While many believe that payday and other predatory loan activities are inherently unsafe, unsound and inappropriate for financial institutions, it is clear that many vile products could be seen as safe and sound because they are profitable, even though they may be unfair and deceptive. How do you plan to resolve this contradiction and exercise enforcement in these areas?

As noted in our response to Question 12, the OCC has already taken enforcement actions against national banks, pursuant to Section 5 of the FTC Act, to remedy unfair or deceptive acts or practices. Moreover, the OCC has developed detailed predatory lending guidance relying on the standards developed by the FTC under Section 5.[20] It is not necessary for the OCC to have rulemaking authority under Section 5 of the FTC Act in order to enforce that statute. In fact, two courts have recently upheld the OCC's authority to enforce the FTC Act.[21] The Federal Reserve Board, which does have rulemaking authority under the FTC Act has also made clear that the bank regulatory agencies can enforce the standards of Section 5 where they find a practice to be unfair or deceptive, even if there is no Federal Reserve Board regulation on point.[22]

In fact, it is common in the supervision of Federal financial institutions for a Federal regulator to enforce rules against the institutions it supervises that were promulgated by another Federal regulator. For example, the Federal Reserve Board's regulations implementing the Truth-in-Lending Act are enforced by the OCC for national banks, the OTS for Federal thrifts, the FDIC for state non-member banks, and the Federal Reserve Board for state member banks.

There is no contradiction or inconsistency between the safety and soundness and the consumer protection component of the OCC's mission. A crucial part of our mission is to ensure fair treatment of national bank customers. As we stated in connection with the payday lending enforcement action against First National Bank in Brookings, "Trust is the foundation of the relationship between national banks and their customers. When a bank violates that sense of trust by engaging in unfair or deceptive practices, we will take action – not only to correct the abuses, but to require compensation for customers harmed by those practices."[23] As is demonstrated by our enforcement record, the OCC takes this position whether or not the practices are profitable for the bank.

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[20] The OCC is the first, and thus far the only, Federal banking agency to issue anti-predatory lending guidance. *See* Advisory Letter 2003-2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices," February 18, 2003; Advisory Letter 2003-3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans," February 18, 2003.

[21] *Roberts v. Fleet Bank (RI), National Association*, 342 F.3d 260 (3rd Cir. 2003); *Chavers v. Fleet Bank (RI) N.A.*, 2004 WL 249605, Supreme Court of Rhode Island (Feb. 11, 2004).

[22] *See* Board of Governors for the Federal Reserve System and Federal Deposit Insurance Corporation: "Interagency Guidance on Unfair or Deceptive Acts or Practices by State Chartered Banks" (March 11, 2004), available at www.federalreserve.gov/BoardDocs/Press/bcreg/2004/20040311/attachment.pdf.

[23] OCC News Release 2003-03 (January 21, 2003).

Finally, it bears emphasizing that safety and soundness and fair treatment of customers are consistent goals in our supervision of national banks. Failure to treat customers fairly can result in reputation and litigation risk, which can impact the safe and sound operation of a national bank.

7. Please provide a copy of the OCC's amicus brief and other relevant documents in the case of Fleet Boston in Rhode Island regarding Rhode Island state law on unfair and deceptive acts and practices and any similar briefs the OCC has filed in connection with cases entailing private consumer litigation in which the relevant state agency is not a party.

Attached are the briefs the OCC has filed in private litigation in which the relevant state agency is not a party, that involve the application of state unfair and deceptive practices laws.

Roberts v. Fleet Bank (RI), National Association, Civil Action No. 006142, U.S. District Court for the Eastern District of Pennsylvania, Memorandum of Law of the OCC as Amicus Curiae, August 15, 2001.

Roberts v. Fleet Bank (RI), National Association, No. 01-4420, U.S. Court of Appeals for the Third Circuit, Brief of the OCC as Amicus Curiae in Support of Defendants/Appellees Requesting that the Decision of the District Court be Affirmed, May 15, 2002.

Related Decisions: *Roberts v. Fleet Bank (RI), National Association*, 2001 WL 1486226 (E.D. Pa. 2001) (granting defendant's motion for summary judgment; plaintiff may not pursue a claim for violation of RI UDAP law because statute contains an exemption for transactions otherwise subject to regulation by a Federal regulator).

Roberts v. Fleet Bank (RI), National Association, 342 F.3d 260 (3rd Cir. 2003) (affirmed district court decision regarding RI UDAP law claim; pursuant to its authority to bring enforcement actions against national banks for violations of law or regulation, OCC has the power to regulate false and misleading advertising under section 5 of the FTC Act).

Chavers v. Fleet Bank (RI), N.A., et al., No. 02-201 Rhode Island Supreme Court, Brief of the OCC as Amicus Curiae in Support of Defendants/Appellees Requesting that the Decision of the Superior Court be Affirmed, filed January 3, 2003.

Related decisions: *Chavers v. Fleet Bank (RI) N.A.*, unpublished opinion, 2001 WL 506776, Superior Court of Rhode Island (April 20, 2001) (denying defendant's motion to dismiss on the grounds that it was exempt under the RI UDAP law as an entity regulated by a Federal agency).

Chavers v. Fleet Bank (RI) N.A., unpublished opinion, 2001 WL 770904, Superior Court of Rhode Island (June 29, 2001) (denying defendant's motion for reconsideration).

Chavers v. Fleet Bank (RI) N.A., 2002 WL 481797, Superior Court of Rhode Island (Feb. 25, 2002) (granting defendant's motion for

summary judgment regarding plaintiff's claim alleging violations of RI UDAP law due to OCC's regulation of defendant).

Chavers v. Fleet Bank (RI) N.A., 2004 WL 249605, Supreme Court of Rhode Island (Feb. 11, 2004) (relies on *Roberts*; OCC has the power to enforce national banks' compliance with the FTC Act).

8. In previous testimony, there is an attempt to justify the timing and necessity of the OCC's action by claiming that the variety of state predatory lending laws is creating too much uncertainty in the secondary markets and sounding the death knell for the extension of credit in high cost loan situations. However, this argument for preemption seems a little disingenuous because the vast majority of the rating agencies and secondary purchasers you cite as examples in your testimony also will not rate or buy loans under HOEPA, the federal law that governs high cost loans. Most of the state laws you cite are very similar to HOEPA, although some extend protection a little farther. Generally, Salomon Brothers and a few other specialists are the only ones who participate in this market. However, it appears that the market has found solutions to the issue of open ended liability in New York, for example, by requiring warranties and representations. And there are some software programs that will allow potential purchasers of these loans to screen for (and price for) any state law issues. Does the OCC plan to address this issue, namely that several companies have already developed compliance software for these state laws, and guarantee the systems' ability to identify loans violating state predatory lending laws? It seems that this problem you refer to may have a number of solutions. And the very issue that creates the perceived problem is one of federal law. Are you intending to fail to enforce HOEPA in order to create uniformity for the secondary markets?

We will, of course, continue to apply and enforce the HOEPA, which contains Federal anti-predatory lending standards that are fully applicable to national banks and their operating subsidiaries.

As we indicated in the response to Question 2, the adverse impact of state anti-predatory lending laws on the ability of national banks and their operating subsidiaries to exercise their Federally authorized real estate lending powers was a factor in our decision to adopt the final rules. Among other effects, state anti-predatory lending laws adversely impact national banks' lending authority because they restrict access to the secondary market in which national banks sell the loans they originate. The fact that some states' anti-predatory lending laws contain some features that are similar to the Federal HOEPA is not relevant to the impact of these state laws on secondary market access. It is the state-by-state evaluation of the effects of these state laws by secondary market purchasers and the rating agencies, that curtail national banks' participation in the secondary market.

The coverage of state anti-predatory lending laws is frequently different from HOEPA coverage. For example, HOEPA does not apply to purchase money mortgage loans. Many states' laws do. States' laws also differ from HOEPA, and from one another, with respect to the interest rates and fees that trigger coverage of a loan as a "high cost loan." Finally, the state laws are not uniform in their provisions for assignee liability. Some states permit uncapped, and thus unquantifiable, assignee liability. Others impose limitations on assignee liability.

These differences are significant, and they have significantly different practical consequences. While Fannie Mae and Freddie Mac have said that they will not buy HOEPA loans, these government sponsored enterprises (GSEs) have not made similarly definitive statements with respect to loans originated in all states with anti-predatory lending laws. Instead, they evaluate whether to purchase on a state-by-state basis. Thus far, Fannie and Freddie have issued statements indicating that they will not purchase loans in many states that have anti-predatory

lending laws, but not in every state. For example, Fannie Mae and Freddie Mac have not announced prohibitions on the purchase of "high cost" loans as defined by the North Carolina law.

Similarly, the rating agencies, whose assignment of ratings is essential to the ability to privately securitize mortgage loans, currently take a state-by-state approach to determining whether they will rate securitizations containing high cost loans. S&P, Moody's, and Fitch have issued policies concerning the inclusion of "high cost loans" from jurisdictions with anti-predatory lending laws in structured finance transactions.[24] Under these policies, the rating agencies generally will not rate residential mortgage backed securities (RMBS) structured finance transactions containing loans that carry unquantifiable assignee liability. Therefore, loans originated in states with anti-predatory lending laws providing for uncapped or unascertainable assignee liability must generally be excluded from a securitization in order for the transaction to be rated. [25]

S&P and Fitch will rate securitizations containing loans originated in states with anti-predatory lending laws that provide for limited, or quantifiable, assignee liability, but only subject to additional credit enhancements and additional representations and warranties.

These secondary market constraints exist despite the availability of computer compliance software. Indeed, the rating agencies expect the use of such technology by lenders as *one part* of their screening process.[26]

These constraints translate into cost burdens at each stage of the lending process. For example, satisfying the extra conditions imposed by a rating agency that is willing to rate a "high-cost" loan securitization may require representations, warranties, sampling, and certifications that go beyond the industry standard. As a result, a bank may be required to increase its compliance staff, provide additional training to both existing and new staff, and pay fees to obtain third-party sampling and certification. If the rating agency requires additional credit enhancement, providing that will generally add to the financial cost of the transaction. Finally, if the bank cannot securitize the loans and must therefore retain them on book, the bank does not realize funds that it could use to make additional loans, the bank will incur carrying costs, and the bank's servicing fee income will be diminished. These costs either will be passed back to the bank's

[24] *See* Standard & Poor's: "Evaluating Predatory Lending Laws: Standard & Poors Explains its Approach" (April 15, 2003); Moody's Investor Services: "Impact of Predatory Lending Laws on RMBS Securitizations" (May 6, 2003); and Fitch Press Release: "Fitch Revises its Rating Criteria in the Wake of Predatory Lending Legislation" (May 1, 2003).

[25] *See, e.g.*, "Standard & Poor's Permits Additional New Jersey Mortgage Loans Into Rated SF Transactions" (Nov. 25, 2003) ("Standard & Poor's will continue to exclude High-Cost Home Loans because of the potential for uncapped statutory and punitive damages."); and Mortgage Bankers Association Industry News: "Fitch Ratings Addresses New Mexico Predatory Lending Legislation" (Jan. 15, 2004)("Since a lender or assignee of any 'high-cost home loan' may be subject to unlimited liability under the Act, Fitch will not rate RMBS transactions containing high-cost home loans originated in New Mexico as of Jan.1, 2004.").

[26] *See* Fitch Ratings "Can You See Me Now? Screening for RMBS Predatory Lending Loans" (November 12, 2003) (discussing various aspects of originator due diligence practices).

customers or, if the bank concludes they are unacceptably high, will compel the bank to stop making loans covered by state anti-predatory lending laws.

The rating agencies have, however, responded favorably to preemption decisions by the Federal banking agencies. Shortly after Fitch announced that it would not rate residential mortgage backed securitizations containing high cost home loans originated in New Mexico, Fitch also announced that, beginning the day the OCC's preemption rule becomes effective (February 12, 2004), it *will* rate residential mortgage backed securitizations containing loans subject to any state or local anti-predatory lending laws that were originated by OCC-regulated national banks or their operating subsidiaries without additional credit enhancements.[27] This follows Fitch's August 22, 2003, decisions to rate securitizations without additional credit enhancement by OCC-regulated lenders in Georgia in light of the OCC's Preemption Order and Determination concerning the GFLA,[28] and by OTS-regulated lenders in all jurisdictions in light of the OTS's preemption regulations and various preemption opinions.[29]

On October 3, 2003, S&P made the same decision concerning the GFLA Determination and Order.[30] On March 3, 2004, S&P announced that it had completed its review of the real estate lending provisions in the OCC's preemption rule[31] and that, as a result, it will rate securitizations containing loans originated by national banks or their operating subsidiaries in Georgia, Illinois, Kentucky, Maine, Nevada, New Jersey, New Mexico, New York, North Carolina, Oklahoma, and South Carolina. For loans originated in these jurisdictions, S&P will continue to rely on the seller's representation and warranty that the loans included in the pool were originated in compliance with all applicable laws, including anti-predatory lending laws. In addition, S&P will require legal comfort in the form of an officer's certificate indicating that the originator of the loan is a national bank or a national bank operating subsidiary.[32]

These decisions are critical because, without a certain secondary market for these loans, banks making risk-priced loans covered by this type of State law will be required to hold more of these loans to maturity. This, in turn, ties up more of a bank's capital as it carries the mortgage assets on its books, and adversely affects the ability of the bank to originate or acquire new loans.

[27] *See* "Fitch Ratings Addresses Preemption Statement from the OCC" (Jan. 16, 2004).

[28] *See* 68 Fed. Reg. 46264 (Aug. 5, 2003).

[29] *See* "Fitch Ratings Addresses Preemption Statements from the OTS and OCC" (Aug. 22, 2003).

[30] *See* "S&P Announces Position on OCC's Preemption Order for the GFLA" (Oct. 3, 2003).

[31] On November 25, 2003, having reviewed the OTS's preemption opinions concerning the anti-predatory lending laws in Georgia, New Jersey, New Mexico, and New York, S&P announced that it would no longer apply its published criteria to Federal thrifts and their operating subsidiaries operating in those states. *See* "S&P Announces Position on OTS Preemption Pronouncements" (Nov. 25, 2003).

[32] *See* "S&P Addresses OCC Rule Regarding Preemption of State Anti-Predatory Lending Laws" (March 3, 2004). S&P said it was unable to conclude with certainty that assignees and purchasers of loans originated by national banks in Arkansas are not subject to liability. Therefore, S&P said, it will continue to apply its previously announced criteria with respect to such loans.

As a result of these higher costs and operational challenges, lenders must absorb the costs, pass the costs on to consumers, or discontinue offering various products in jurisdictions where the costs or exposure to uncertain liabilities are prohibitive. It has been reported that three major lenders have announced they will no longer do business in New Jersey because of the State's predatory lending law, and, reportedly, at least 18 have significantly limited their lending activities there.[33] As lenders react like this, legitimate credit availability is reduced and consumers will have fewer options for home loans.

[33] *See* Paul Muolo and Brad Finkelstein, *Lenders Leaving New Jersey*, Dec. 2003, American Banker-Bond Buyer, Vol 13, No. 3 at 41.

9. The proposed regulations seem to indicate that the OCC will no longer engage in the preemption procedure that was established by Congress in Riegle-Neal. Will the OCC continue to provide notice and a comment period when it preempts state consumer protection laws?

We will continue to provide notice in the *Federal Register* of, and an opportunity to comment on, requests asking whether a type of state law that is *not listed* in our preemption rule is preempted. Requests pertaining to types of state laws that are listed in our preemption rule need not be published under the Riegle-Neal requirements[34] because the preemption determination has already been made – pursuant to notice and comment procedures – in the regulation.

[34] *See* 12 U.S.C § 43.

10. The OCC has a history of inconsistency with regard to its preemption authority and seems to be engaging in revisionist history.

- *In 1982, the OCC issued a regulation that listed five categories of state law that do not apply to real estate lending by national banks (relating to the loan to value ratio, the repayment schedule, the term, maximum loan amount and covenants and restrictions necessary to qualify a leasehold as an acceptable security).*
- *In a 1992 letter, the OCC stated, "The states also concurrently regulate real estate lending. The OCC's regulation provided for limited preemption of such state statutes in the case of national banks."*
- *In a 2002 case, Bank of America v. City and County of San Francisco, the OCC recognized state law application to national banks in a number of fields, including unfair and deceptive acts.*

How do you resolve these past statements with your current action? Similarly, the OCC's website currently states that "The OCC does not have a mandate to engage in consumer advocacy, but it is responsible for ensuring the safety and soundness of the national banking system." Do you envision that this mandate will change, given this new regulation preempting state enforcement? If not, will the OCC provide another mechanism to enforce consumer claims against banks?

Consistency of the OCC's preemption positions

The OCC's new preemption rule is fully consistent with positions we have taken previously, including those noted in your question. We have long recognized, as have the courts, that the OCC has broad rulemaking and preemptive rulemaking authority under 12 U.S.C. §§ 371 and 93a. With regard to the earlier version of our real estate regulations to which this question refers, we expressly reserved the right to exercise this authority more broadly. In the preamble to that regulation, the OCC stated that we were clarifying a "limited scope of preemption" by preempting "*at this time*, only those state laws that govern in those areas" encompassed in the five categories set forth in that rule. Thus, this earlier rulemaking left room for an expanded preemptive scope in the future.

The expanded list of preempted state laws in our new rule reflects recent Supreme Court and lower Federal court rulings concerning the applicability of state laws that attempt to regulate national bank activities. In each case, the court determined that the state or local restriction obstructed, impaired, or conditioned the exercise of an authorized national bank power and therefore was preempted by operation of the Supremacy Clause. *See, e.g., Barnett Bank of Marion County v. Nelson*, 517 U.S. 25 (1996); *Bank of America v. City & County of San Francisco*, 309 F.3d 551 (9th Cir. 2002), *cert. denied*, 123 S.Ct. 2220, 2003 U.S. LEXIS 4253 (May 27, 2003) (the National Bank Act and OCC regulations together preempt conflicting state limitations on the authority of national banks to collect fees for the provision of electronic services through ATMs; municipal ordinances prohibiting such fees are invalid under the Supremacy Clause); *Wells Fargo Bank, Texas, N.A. v. James*, 321 F.3d 488 (5th Cir. 2003)

(Texas statute prohibiting certain check cashing fees is preempted by the National Bank Act); *Metrobank v. Foster*, 193 F. Supp. 2d 1156 (S.D. Iowa 2002) (national bank authority to charge fees for ATM use preempted Iowa prohibition on such fees). *See also Bank One, Utah v. Guttau*, 190 F.3d 844 (8th Cir. 1999), *cert. denied sub nom Foster v. Bank One, Utah*, 529 U.S. 1087 (2000) (holding that Federal law preempted Iowa restrictions on ATM operation, location, and advertising).

Our 1992 letter responded to an inquiry on behalf of several *state* chartered banks. The "concurrent regulation" by the states over real estate lending refers to two aspects of regulation. One is the state's regulation of real estate lending by entities under the state's supervision. Nothing in our preemption rule deprives the states of this ability.

The second aspect is, of course, the application of state law to national banks. Under our new rule, certain state laws, such as most state unfair and deceptive trade practices laws and those laws identified by the Ninth Circuit in *Bank of America* – state laws on contracts, rights to collect debts, acquisition and transfer of property, taxation, zoning, crimes, and torts – remain applicable to national banks.

The OCC's commitment to consumer protection

The statement that the OCC does not have a mandate to engage in consumer *advocacy* is taken from a description of our OCC's Customer Assistance Group. As described in that document and in our response to Question 14, the OCC does, however, actively participate in the resolution of complaints and concerns raised by national bank customers. Thus, although we do not represent consumers, our mission – as also evidenced by our record of vigorous enforcement action when problems arise – includes ensuring the fair treatment of national bank customers. National banks and their operating subsidiaries are subject to extensive Federal consumer protection laws and regulations, administered and enforced by the OCC.[35] OCC examinations of national banks and national bank operating subsidiaries are conducted to ensure and enforce compliance with these laws and regulations and supplemental OCC supervisory standards. The OCC's ample supervisory resources are detailed below in response to Question 13.

[35] Federal consumer protection laws and regulations that apply to national banks and to national bank operating subsidiaries include: the Federal Trade Commission Act; Truth in Lending Act; Home Ownership and Equity Protection Act; Fair Housing Act; Equal Credit Opportunity Act; Real Estate Settlement Procedures Act; Community Reinvestment Act; Truth in Savings Act; Electronic Fund Transfer Act; Expedited Funds Availability Act; Flood Disaster Protection Act; Home Mortgage Disclosure Act; Fair Housing Home Loan Data System; Credit Practices Rule; Fair Credit Reporting Act; Federal Privacy Laws; Fair Debt Collection Practices Act; the new OCC anti-predatory lending rules in 12 C.F.R. Parts 7 and 34; OCC rules imposing consumer protections in connection with the sales of debt cancellation and suspension agreements; OCC standards on unfair and deceptive practices (www.occ.treas.gov/ftp/advisory/2002-3.doc.); and OCC standards on preventing predatory and abusive practices in direct lending and brokered and purchased loan transactions (www.occ.treas.gov/ftp/advisory/2003-2.doc. and www.occ.treas.gov/ftp/advisory/2003-3.doc.).

11. We have previously requested copies of all testimony by the OCC in connection with the Riegle-Neal legislation. Please provide that data as soon as possible.

Attached are the following documents:

Statement and Testimony of Hon. Eugene A. Ludwig, Comptroller of the Currency from a Hearing on Interstate Banking and Branching before the Subcommittee on Financial Institutions Supervision, Regulation and Deposit Insurance of the Committee on Banking, Finance and Urban Affairs of the House of Representatives, 103rd Congress, 1st Session, October 26, 1993.

Statements, Prepared Statements, and Response to Written Questions from Senator Riegle of Eugene A. Ludwig, Comptroller of the Currency from Hearings on Interstate Banking and Insurance Activities of National Banks before the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate, 103rd Congress, 1st Session, October 5 and November 3, 1993.

12. Please provide a list of cases and relevant details where the OCC has sued institutions for predatory lending, fraud and any other consumer law violations as well as the amount of damages collected by the OCC and by consumers.

Recent OCC Consumer Protection Enforcement Actions

A. Unfair and Deceptive Practices under the FTC Act:

The OCC has obtained hundreds of millions of dollars in restitution for national bank customers in the following enforcement actions:

Clear Lake National Bank, San Antonio, Texas (11/7/03) (consent order) (required more than $100,000 in restitution of fees, finance charges, and interest related to unfair/predatory practices involving mortgage loans to pay off tax liens) (FTC Act, HOEPA, TILA, and RESPA) www.occ.treas.gov/ftp/eas/ea2003-135.pdf

First Consumers National Bank, Beaverton, Oregon (7/31/03) (formal agreement) (required restitution of more than $1.65 million in annual fees and overlimit fees for deceptive credit card practices) (FTC Act) www.occ.treas.gov/ftp/eas/ea2000-100.pdf

Household Bank (SB), National Association, Las Vegas, NV (3/25/03) (formal agreement) (required restitution of more than $4.5 million for deceptive practices in connection with private label credit cards) (various legal theories) www.occ.treas.gov/ftp/eas/ea2003-17.pdf

First National Bank in Brookings, Brookings, South Dakota (1/17/03) (consent order) (required restitution of more than $6 million for deceptive credit card practices) (FTC Act and payday lending) www.occ.treas.gov/ftp/eas/ea2003-1.pdf

First National Bank of Marin, Las Vegas Nevada (12/3/01) (consent order) (required restitution of more than $4 million for deceptive credit card marketing) (FTC Act) www.occ.treas.gov/ftp/eas/ea2001-97.pdf

Direct Merchants National Bank (5/3/2001) (consent order) (required restitution of more than $3.2 million for deceptive credit card marketing) (FTC Act) www.occ.treas.gov/ftp/eas/ea2001-24.pdf

Providian National Bank, Tilton, New Hampshire (6/28/00) (consent order) (required more than $300 million in restitution for deceptive credit marketing) (FTC Act, TILA, and state law) www.occ.treas.gov/ftp/eas/ea2000-53.pdf

B. Payday Lending:

Peoples National Bank, Paris, Texas (1/30/03) (consent order) (civil money penalties assessed for the bank's violations of Federal consumer protection statutes) www.occ.treas.gov/ftp/eas/ea2003-2.pdf.

First National Bank in Brookings, Brookings, South Dakota, (1/17/03) (consent order) (as noted previously, we also ordered restitution in this action) www.occ.treas.gov/ftp/eas/ea2003-1.pdf

Goleta National Bank, Goleta, California (10/28/02) (consent order) (civil money penalties assessed for the bank's violations of Federal consumer protection statutes) www.occ.treas.gov/ftp/eas/ea2002-93.pdf

Eagle National Bank, Upper Darby, Pennsylvania (12/18/01) (consent order) (bank required to discontinue its payday loan program) www.occ.treas.gov/ftp/eas/ea2001-104.pdf

13. What steps has the OCC taken to implement these regulations and ensure that the agency has the resources to fulfill its newly expanded responsibilities? Does the OCC believe that these regulations adequately address the issue of predatory lending, considering the Agency's assertion that national banks do not partake in this practice? Does this create an un-level playing field, and does more need to be done?

The OCC's resources

National banks and their operating subsidiaries are highly regulated and closely supervised. Today, the OCC supervises approximately 2100 national banks, together with their operating subsidiaries. Compliance and enforcement at the OCC are carried out through our corps of bank examiners and attorneys. We have nearly 1700 examiners in the field, hundreds of whom are involved in both safety and soundness and compliance supervision. Over 100 examiners throughout the country work exclusively on compliance supervision. We have over 300 examiners on site at our largest national banks, engaged in continuous supervision of all aspects of their operations. These resources are supplemented by dozens of attorneys in our district offices and Washington D.C. who work on compliance matters.

The employees in our Customer Assistance Group (CAG), located in Houston, Texas, further supplement these functions.[36] The CAG provides direct assistance to customers of national banks and their subsidiaries to resolve individual complaints. It also collates and disseminates complaint data that help point our examiners toward banks, activities, and products that require further investigation or transaction testing through product sampling. While the CAG is an important supplement to our compliance supervision functions, it is by no means all there is to it.

It is important to note, by way of comparison, based on data published by the Conference of State Bank Supervisors, State banking departments collectively supervise approximately 113,000 entities, of which approximately 6,000 are commercial banks.[37] For all these entities, the states report that they have 2,308 examiners.[38] Thus, if one were to look only at commercial banks and assume all state examiners were dedicated to commercial bank supervision, OCC's resources exceed those of the states on a per-supervised bank basis. But, in fact, state banking departments are responsible for many entities in addition to commercial banks. These include, depending on the state, savings banks, thrifts, credit unions, bank holding companies, mortgage bankers and brokers, industrial loan companies, non-bank trust companies, money transmitters, consumer finance companies, other licensed lenders, payday lenders, title lenders, check cashers, pawnshops, bankers' banks, securities brokers and dealers, and funeral parlors. Thus, on a per-supervised entity basis, the OCC has significantly more resources than do the states. This is exactly the opposite of what some critics of our regulations have suggested. These suggestions – that our resources are inadequate to enable the OCC to supervise compliance effectively or to fulfill the consumer protection aspect of our mission – are simply without foundation.

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[36] The December 2002 Report of the Ombudsman, which describes the CAG and provides other useful information, is attached.

[37] *See A Profile of State Chartered Banking*, 19th Edition, 2002-2003, Conference of State Bank Supervisors.

[38] *See Id.*

Federal consumer protections

There is scant evidence that national banks and their operating subsidiaries are engaged in predatory practices. This conclusion is borne out not only by our own supervisory experience, but also by an extensive study of predatory lending conducted by the Department of Housing and Urban Development (HUD) and the Treasury Department.[39] Moreover, in a brief submitted in support of an OTS rulemaking concerning preemption of state lending standards, 46 State Attorneys General said that:

> predatory lending abuses are largely confined to the subprime mortgage lending market and to *non-depository institutions. Almost all of the leading subprime lenders are mortgage companies and finance companies, not banks or direct bank subsidiaries.*[40]

All 50 State Attorneys General reiterated this point in their comment letter to the OCC on the proposal that preceded our final preemption rule, saying:

> It is true that most complaints and state enforcement actions involving mortgage lending practices have not been directed at banks. However, most major subprime mortgage lenders are now subsidiaries of bank holding companies, *(although not direct bank operating subsidiaries)*.[41]

It is important, in our view, that the Attorneys General, who have been clear about their disagreement with our preemption rule, have not found national banks and their operating subsidiaries to be engaged in predatory lending to any discernable degree. This point underscores that the approach the OCC has taken to combating predatory and abusive lending

[39] A Treasury-HUD joint report issued in 2000 found that predatory lending practices in the subprime market are less likely to occur in lending by –

> banks, thrifts, and credit unions that are subject to extensive oversight and regulation . . . . The subprime mortgage and finance companies that dominate mortgage lending in many low-income and minority communities, while subject to the same consumer protection laws, are not subject to as much federal oversight as their prime market counterparts – who are largely federally-supervised banks, thrifts, and credit unions. The absence of such accountability may create an environment where predatory practices flourish because they are unlikely to be detected.

Departments of Housing and Urban Development and the Treasury, "Curbing Predatory Home Mortgage Lending: A Joint Report" 17-18 (June 2000), available at www.treas.gov/press/releases/report3076.htm.

In addition, the report found that a significant source of abusive lending practices is non-regulated mortgage brokers and similar intermediaries who, because they "do not actually take on the credit risk of making the loan, . . . may be less concerned about the loan's ultimate repayment, and more concerned with the fee income they earn from the transaction." *Id.* at 40.

[40] Brief for Amicus Curiae State Attorneys General, *Nat'l Home Equity Mortgage Ass'n v. OTS*, Civil Action No. 02-2506 (GK) (D.D.C.) at 10-11 (emphasis added).

[41] National Association of Attorneys General, Comment Letter Re: Docket No. 03-16 (dated Oct. 6, 2003) at 10 (emphasis added).

practices is tailored, appropriately, to the extent that the issue exists in the national banking system.

As described in our answer to Question 2, our new preemption rule contains a new anti-predatory lending standard. It also provides that, in connection with *any* type of lending, national banks may not engage in unfair and deceptive practices within the meaning of Section 5 of the FTC Act. Many practices typical of predatory lending, such as "equity stripping," and "loan flipping," would be characterized as unfair or deceptive under Section 5 and thus would be barred under our new rule. Together, the new regulatory provisions, our existing supervisory guidance, and other Federal consumer protection laws provide a comprehensive framework governing our supervision of national banks' lending operations to protect against predatory lending practices. And, as described above, we have the resources to do the job.

14. Please provide the following information for the past three years, broken down by year, segregated by State location of the subsidiary (if applicable):

- *Total number of national bank operating subsidiaries under the supervisory jurisdiction of the OCC*
- *List of the operating subsidiaries and their respective type of business which are under the supervision of the OCC*
- *Total number of operating subsidiary examinations and the total number of consumer complaint investigations completed by the OCC*
- *List the total number of enforcement actions (by type) against all banks and operating subsidiaries under the OCC's supervision*
- *Total amount of consumer restitution ordered from OCC investigations of all national banks and operating subsidiaries*
- *Number of written and telephone inquiries and complaints the OCC has received and processed regarding operating subsidiaries and banks under the supervision of the OCC*
- *Average response time for these telephone and written inquiries*
- *Average amount of time spent to resolve both consumer complaints and inquiries on operating subsidiaries and banks under the supervision of the OCC*
- *Percentage of complaints resolved in the consumer's favor*
- *Total number and location of OCC staff exclusively engaged in processing of complaints and inquiries from consumers, and, separately, the number and location of OCC staff primarily engaged in monitoring and enforcing compliance with federal and state consumer protection laws by national banks and national bank operating subsidiaries. Also, please provide the grade level and location of those staff members. How many of these are attorneys trained in consumer law? (If there is no staff exclusively involved in this process, please give the average amount of time staff devotes to investigate consumer complaints and inquiries regarding operating subsidiaries.)*
- *Please indicate the outreach the OCC is doing to educate the general public and ensure that people know where to file complaints and settle disputes*
- *Does OCC staff responsible for consumer compliance review for compliance with both Federal and State laws and regulations? If yes, please provide a sample of responses from OCC regarding a state issue.*
- *All correspondence to consumers regarding compliance with a state consumer protection law or regulation that the OCC has preempted*
- *A copy of any section of an OCC manual (compliance, safety and soundness, or complaint) that references a procedure for investigating an operating subsidiary*
- *The number of examiners that are exclusively trained for and examine operating subsidiaries*

- *Total number of examiners and, as a subset, total number of compliance examiners*
- *Total number of operating subsidiaries (detailed by asset category) that were not examined during an OCC examination of the parent national bank*

Operating subsidiaries

A comprehensive listing of subsidiaries (and affiliates) of national banks is contained in the National Information Center (NIC) database available at www.ffiec.gov/nic/. The NIC provides comprehensive information on banks and other institutions for which the Federal Reserve Board has a supervisory, regulatory, or research interest, including national banks. The NIC includes the organizational structure of these institutions, and the operating subsidiaries of national banks are identified in the database.

There are approximately 350 operating subsidiaries held by national banks that do business with consumers and are supervised by the OCC. The number of operating subsidiaries will fluctuate somewhat with changes in the business operations of national banks. The attached table lists the names of these entities, their location, their parent bank, and their line of business. A version of this table is available on the OCC's website at www.occ.treas.gov/OpSublist.pdf. (Many other operating subsidiaries are engaged in activities such as securities brokerage and insurance sales, that cause them to be "functionally regulated" by securities or insurance regulators, rather than the OCC, pursuant to the Gramm-Leach-Bliley Act.) In addition, we have proposed a regulation to require national banks to file periodic reports listing all operating subsidiaries within our jurisdiction that engage in transactions with consumers.[42]

Operating subsidiaries generally are examined together with their parent bank. We supervise our banks by business line, not according to corporate form. Activities conducted in operating subsidiaries are subject to the same level of scrutiny that is applied to activities conducted directly in a bank.

The examination handbooks and resources[43] we use in the supervision of national banks instruct our examiners to evaluate activities done through an operating subsidiary. For instance, we require our examiners to: (1) test operating subsidiaries for compliance with established policies, practices, procedures, and internal controls in conjunction with other examination procedures; and (2) sample transactions between the operating subsidiary and the parent bank. This would require, in the case of a bank's mortgage banking business, our examiners to follow that business everywhere in the banking organization that it is conducted. Thus, a sample of mortgage loans will include loans originated at mortgage operating subsidiaries as well as loans originated at the bank itself.

This approach is consistent with the operating subsidiary's status for supervisory purposes as a department or division of its parent bank. For example:

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[42] *See* 69 Fed. Reg. 15260 (March 25, 2004).

[43] Copies of these materials are attached.

- Our rules require that the book figures of a parent national bank and its operating subsidiary be combined for purposes of applying statutory or regulatory limits, like lending limits or dividend restrictions.
- We also apply reporting requirements on a consolidated basis – a national bank's call report contains consolidated figures reflecting, *e.g.*, assets and liabilities at the parent and the operating subsidiary level.
- Finally, our exam ratings and supervisory evaluations reflect the consolidated entity. The CAMELS rating – which covers capital, asset quality, management, earnings liquidity, and sensitivity to market risk – is assigned on the basis of the consolidated operations of the bank and its operating subsidiaries. Our supervisory evaluations of a bank's information systems and compliance with applicable law are done in the same way.

Enforcement actions

Please see our response to Question 12 for a list of enforcement actions.

OCC staffing

As described in response to Question 13, we have 1700 examiners throughout the country involved in both safety and soundness and compliance supervision and over 100 examiners nationwide working exclusively on compliance issues. Pay grades for examiners range from NB IV up to NB IX[44] (for the most senior managers). These resources are supplemented by the attorneys in our District Offices and Washington, D.C. who work on compliance matters and by our Consumer Assistance Group (CAG) in Houston, Texas.

The OCC Law Department has 119 lawyers, 27 of whom are located in our District Offices. Consumer matters are handled by lawyers in our District Offices as well as our Washington, D.C. headquarters. In Washington, one division works exclusively on such issues. The Community and Consumer Law (CCL) Division is comprised of 7 lawyers that specialize in consumer law. The Enforcement and Compliance (E&C) Division has 21 lawyers, who work on matters such as those listed in our response to Question 12. Pay grades for OCC lawyers range from NB IV up to NB IX (for the most senior managers.)

There are 40 CAG employees. Their pay grades range from NB III to NB VIII.

Consumer inquiries and complaints 2001-2003

- **Number of Inquiries and Complaints.** CAG received 228,399 written, e-mail, and telephone inquiries and complaints. Of this number, 114,491 were actual complaints.
- **Total Number of Consumer Complaints Completed.** CAG completed 87,043 consumer complaint investigations of the 114,491 consumer complaints. The difference, 27,448, represents complaints that were closed because the consumer did not provide

[44] As of January 2004, base salary ranges are as follows: for NB IV, $38,714 to $69,686; for NB V, $52,751 to $94,951; for NB VI, $69,832 to $125,698; for NB VII, $89,940 to $161,893; for NBVIII, $114,869 to $203,301; and for NB IX, $149,166 to $223,681. Salaries in the NB VIII and NB IX bands are restricted by a 2004 pay cap.

requested information needed to investigate the complaint, complaints resolved by banks and withdrawn by the consumer, and complex complaints and appeals still in process.

- **Correspondence to Consumers Regarding Preemption of State Law.** Your request asked for all correspondence to consumers regarding compliance by national banks with a state consumer protection law or regulation that the OCC has preempted. We understand this to refer to preemption opinions sent to consumers. It has been our position that we address preemption issues when they are presented by an affected national bank; thus we do not provide such opinions to consumers.
- **Response time.** Approximately 80% of the telephone inquiries were answered within 3 minutes. Over 80% of complaints and inquiries were resolved within 60 days. Written complaints were acknowledged within 5 days.
- **Total Restitution Resulting from Matters Handled by CAG.** Banks paid $15,559,863.97 in restitution to 14,719 consumers resulting from matters handled by CAG.
- **Total Restitution Ordered from Enforcement Actions.** $20,602,159 of restitution was ordered from OCC enforcement actions.[45]

<u>**OCC consumer outreach**</u>

The OCC reaches out to consumers in a variety of ways including:

- Through its Community Affairs Department, the OCC conducts an extensive community outreach program with community organizations and consumer protection advocates. Hosted by the Comptroller, First Senior Deputy Comptroller, and/or other senior OCC officials, these meetings educate the general public about compliance issues and ensure that bank customers know where to file complaints and settle disputes. Attached is a compilation of outreach meetings held from 2001 to the present, including the name of the organization and the date of the meeting.

- CAG provides educational counseling by telephone, in both English and Spanish, to approximately 100 consumers each business day concerning the operations of national banks and national bank products. In addition, CAG also provides an informational brochure to national banks for distribution to consumers. This brochure describes the OCC, the kind of banks it regulates, what to do if a consumer has a problem with a national bank, how to contact CAG, how to file a written complaint, and provides referral information to other Federal regulators. Copies of the brochure are attached.

- On our website, we list information regarding numerous OCC efforts to prevent and combat abusive lending practices, as well as information describing CAG and how to contact CAG.

[45] We note that our enforcement action against Providian National Bank, Tilton, New Hampshire in which we required more than $300 million in restitution occurred in 2000, prior to the time frame covered by this request.

Congress of the United States
House of Representatives
Washington, DC 20515

December 1, 2003

The Honorable John D. Hawke, Jr.
Comptroller
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219

Dear Comptroller Hawke:

We, the undersigned Members of the House Financial Services Committee from the State of New York, are writing you in regard to the recent Notice of Proposed Rule Making, which amends Parts 7 and 34 of regulations by the Office of the Comptroller of the Currency (OCC). The proposed rule attempts to give the OCC the extremely broad power of "field preemption" for both national banks and their operating subsidiaries.

This is the latest, and most far reaching, action in a series of regulatory steps that the OCC has taken without Congressional review. Federal statutes clearly subject national banks to state consumer protection and bank branching laws, as well as any state legislative regulation of national bank activities - particularly standards affecting consumer financial transactions. If such changes are to be made, they should be made after a thorough public review by Congress. The laws of fifty states should not be preempted by a federal regulator without public debate.

These proposals make significant changes to the financial regulatory structure and state law enforcement authority. We are concerned that exclusive federal regulatory oversight of these entities will result in lesser, not greater, protections for consumers.

We urge you to refrain from finalizing these proposed regulations, until Congress has had the opportunity to review these proposals and signal our intent.

Sincerely yours,

Sue Kelly
Rep. Sue Kelly

Peter King
Rep. Peter King

Carolyn B. Maloney
Rep. Carolyn Maloney

Carolyn McCarthy
Rep. Carolyn McCarthy

RON WYDEN
OREGON

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United States Senate

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Committees:

Budget
Commerce, Science & Transportation
Energy & Natural Resources
Environment & Public Works
Select Committee on Intelligence
Special Committee on Aging

Oregon State Offices:

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Portland, OR 97232
(503) 326-7525

151 West 7th Ave
Suite 435
Eugene, OR 97401
(541) 431-0229

Sac Annex Building
105 Fir St
Suite 201
La Grande, OR 97850
(541) 962-7691

U.S. Courthouse
310 West 6th St
Room 118
Medford, OR 97501
(541) 858-5122

The Jamison Building
131 NW Hawthorne Ave
Suite 107
Bend, OR 97701
(541) 330-9142

707 13th St. SE
Suite 285
Salem, OR 97301
(503) 589-4555

December 1, 2003

The Honorable John D. Hawke, Jr.
Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Dear Comptroller Hawke:

I am writing to express my concern regarding the Office of the Comptroller of the Currency's (OCC) proposed new rules on preemption in Docket Number 03-16. I believe this rule could represent a major step backwards for the protection of consumers, by exempting many financial institutions from important state consumer protection statutes without offering a viable federal equivalent.

As I understand it, the proposed rule would substantially expand the scope of OCC preemption under the National Bank Act. National banks, which up to the present have been subject to a variety of state consumer protection laws on matters such as predatory lending and identity theft, would suddenly become exempt. In addition, all affiliates of such banks would become exempt as well.

This prospect is disturbing for a number of reasons. First, the OCC is focused first and foremost on the financial safety and soundness of banks. It is not a consumer protection agency, and it is not at all clear that it has the resources to police potential abuses and deal with consumer complaints at the roughly 2,200 nationally chartered banks. Important consumer protection functions could fall through the cracks.

Second, this rule change could have unintended effects on competition in the financial services industry, because state-chartered financial institutions would be subject to state consumer regulation while their nationally-chartered competitors would not.

Third, this kind of significant change to the regulation of the U.S. banking system should be a matter for the consideration of Congress, after a full public debate. It should not be adopted on an administrative basis, by an agency for which the change would effectively mean an expanded scope of regulatory power.

I understand that various consumer groups and state agencies, including Oregon's Department of Consumer and Business Services, have expressed their strong opposition to the proposed rule. I would urge you to give their arguments the most serious consideration, and to refrain from casting aside the states' traditional ability to provide positive and pro-consumer safeguards. Thank you.

Sincerely,

Ron Wyden

Ron Wyden
United States Senator

November 24, 2003

The Honorable John D. Hawke, Jr.
Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Dear Comptroller Hawke:

We write to express our continuing concern about the Office of the Comptroller of the Currency's ("OCC") positions on the issue of federal preemption of state laws and state enforcement relating to national banks. In recently proposed regulations (Docket No. 03-16), amicus curiae briefs, and official pronouncements, the OCC has adopted an aggressive policy of asserting that most state laws, particularly predatory lending and other consumer protection statutes, do not apply to national banks or to subsidiaries of national banks. We understand that the OCC, pursuant to its "visitorial powers" examination authority, is also asserting that it has the right to supplant all state enforcement of state laws of general application that may affect national banks.

National banks are creatures of federal law and the OCC is the exclusive supervisor of national banks. However, for many years it has been widely accepted by Supreme Court decisions as well as actual practice that national banks are subject to state laws that do not discriminate against, or significantly burden, the operations of national banks. For example, many states have routinely licensed and regulated separately incorporated mortgage companies that happen to be subsidiaries of national banks. In addition, states regularly have enforced their unfair and deceptive practices laws against national banks, without controversy as to the states' enforcement role. Under the OCC's current regimen, such traditional state functions would be eliminated.

Congress has previously voiced its intent that national banks not be immune from coverage by state laws. The House-Senate conference committee report on the 1994 Riegle-Neal Interstate Branching and Bank Efficiency Act stated that: "States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses and communities." In enacting the 1999 Gramm-Leach-Bliley Act in 1999, Congress affirmed the Supreme Court standard in Barnett Bank that state laws applied to national banks unless those laws serve to prohibit or significantly interfere with a national bank's congressionally-authorized powers.

The OCC now appears to be ignoring both the Supreme Court and Congress by pursuing a preemption agenda that would override any state law that has any impact on a national bank. The OCC's actions and proposals would dramatically alter established preemption standards and would radically affect state-federal relations and consumer protection in the areas of banking.

Our nation has been well served by our dual-banking system for the past 140 years. This important balance between federal and state responsibilities should not be upended by precipitous preemption of state laws. We therefore urge you to defer any further rulemaking on preemption of state laws at this time and to vigorously examine claims of predatory lending and other violations of state consumer protection laws by national banks and their operating subsidiaries,

Signed: Senators Paul S. Sarbanes (D-MD), Chris Dodd (D-CT), Tim Johnson (D-SD), Jack Reed (D-RI), Charles Schumer (D-NY), Evan Bayh (D-IN), Zell Miller (D-GA), Tom Carper (D-DE), Debbie Stabenow (D-MI), and Jon Corzine (D-NJ).

Congress of the United States
Washington, DC 20515

November 3, 2003

The Honorable John D. Hawke, Jr.
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Dear Mr. Hawke:

We request that the Office of Comptroller of the Currency (OCC) withdraw proposed rule 68 Fed. Reg. 46119 (2003), at least until an objective study of its consequences can be conducted.

This OCC proposal would preempt virtually all state laws regarding the activities of national banks and their operating subsidiaries unless (i) Congress has expressly incorporated state-law standards in Federal statutes, or (ii) particular state laws have only an "incidental" effect on national banks. According to 68 Fed. Reg. at 46128-29, this proposed rule would preempt all state laws that "obstruct, in whole or in part, or condition" the ability of national banks to conduct their Federally authorized activities.

This OCC proposed rule threatens the state banking system of regulation by promoting a one-size fits all approach that would concentrate essentially all regulatory power over national banks and their subsidiaries in a single individual, the Comptroller. Rather than this broad-sweeping approach, we believe issues of Federal preemption by the OCC of state banking regulations should be handled on a case by case basis.

Furthermore, we believe this proposed regulation is inappropriate since state regulators are in a better position to respond to local consumer protection problems. Under this proposed rule, consumer protection issues that emerge in national banks or their subsidiaries in one or a few states would be addressed by an OCC regulation that would apply to all depository institutions in all states. This approach is inflexible and ignores the historic role of states as the consumer protection regulator for national banks and their subsidiaries.

Nebraska is somewhat unique in that it does not attempt to regulate the activities of a subsidiary of national bank. However, the Nebraska Department of Banking and Finance (NDBF) does regulate affiliates of national banks. If this regulation is adopted, national banks will have the incentive to change its affiliates to subsidiaries. According to the NDBF, affiliates of national banks are the most aggressive in pushing the limits and attempting to find loopholes in consumer protection laws.

Moreover, it is our experience that the OCC has been slow and inefficient in processing consumer banking complaints. If this proposed rule becomes final, we do not see indications that the OCC will increase its staff to process consumer complaints

against national banks and its subsidiaries; nor do we see OCC regulations providing national standards on issues addressed by Nebraska consumer protection laws.

In conclusion, we ask the OCC to withdraw proposed rule 68 Fed. Reg. 46119 (2003) at least until an objective study of its consequences can be conducted. We believe it is important to preserve state regulation of national banks and their subsidiaries. Thank you for your consideration of this letter. If you have any questions, please feel free to contact us.

Best wishes,

Doug Bereuter

DOUG BEREUTER
Member of Congress

Lee Terry

LEE TERRY
Member of Congress

Tom Osborne

TOM OSBORNE
Member of Congress

COMMITTEE ON
ENERGY AND COMMERCE
SUBCOMMITTEES:
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Congress of the United States
House of Representatives
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October 24, 2003

The Honorable John D. Hawke, Jr.
Comptroller of the Currency
U.S. Department of Treasury
250 E Street, S.W.
Washington, D.C. 20219-0001

RE: Docket No. 03-16; Notice of Proposed Rulemaking, 68 Federal Register 46119 (2003)

Dear Mr. Hawke:

As the lone Representative in Congress for the State of Wyoming, I pay particular attention to federal scenarios that pose a threat to the way of life in my great home state. It has been brought to my attention by Wyoming state regulators that the changes in this proposed rule may very well be of this nature.

The potential impact of these changes on the unique rural marketplace Wyoming embodies gives me pause. Not only is there currently an effective balance and functioning relationship between federal and state chartered banks in Wyoming, there are tremendous consumer protections for citizens. Any initiative that would preempt these necessary and positive functions must be extensively scrutinized and justified, if not withdrawn.

Therefore, I request your justification for the effort to apply one size fits all solutions to a state where they never fit. I appreciate your individual and prompt attention to this matter and look forward to hearing from you.

Sincerely,

Barbara Cubin

Barbara Cubin
Member of Congress

BC/bl

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

April 3, 2003

The Honorable John D. Hawke, Jr.
Comptroller of the Currency
250 E. Street, SW
Washington, DC 21219

Dear Mr. Hawke:

It has come to our attention that the Office of the Comptroller of the Currency (OCC) has given notice of its intent to issue an advisory opinion on the applicability of the Georgia Fair Lending Act to national banks and their operating subsidiaries. It is also our understanding that your office may use the opportunity of the advisory opinion to enunciate a broad theory of federal law preemption that might not only nullify the Georgia statute, but could broadly impact all other State laws and regulations seeking to address the problem of predatory mortgage lending.

We believe that such action would violate a clear Congressional directive that States be permitted to augment federal law with more meaningful consumer protections and will needlessly expose millions of vulnerable consumers to abusive lending practices.

The extraordinary growth of subprime mortgage lending over the past decade has made credit and home ownership opportunities available to millions of lower income and minority consumers. Expanding access to credit for such consumers is a goal we've long advocated and continue to pursue. Unfortunately, it has also created what a 2000 Treasury-HUD joint report described as "fertile ground" for a variety of abusive practices that we collectively refer to as predatory lending. In recent years these practices--including deceptive marketing, undisclosed fee charges, excessive penalties and repeated refinancing of unaffordable debt–have stripped millions of hard working families of their equity, their savings and their homes. In areas with high concentrations of predatory loans, the impact goes beyond individual families to devastate entire neighborhoods and undermine the vitality of surrounding communities.

Many states have acted to protect consumers against these predatory practices. Beginning with North Carolina in 1999, at least eight states have enacted comprehensive statutes or regulations aimed at stopping predatory practices. Legislatures in two additional states, New Jersey and New Mexico, have also passed very strong predatory lending statutes that will soon be signed into law. State officials across the Nation have worked to alert the public to the problem of predatory lending and to educate consumers on how to avoid being victimized. These laws and regulations were a response to broad public campaigns, were approved with bipartisan support and were signed and implemented by Democratic and Republican Governors.

Unfortunately, the added consumer protections in these state laws and regulations would be swept away under the broad preemption scheme now reportedly envisioned by the OCC. Over the past year the OCC appears to have moved dramatically from a position that acknowledged the limitations on federal law preemption enunciated by the Supreme Court in Barnett Bank v. Nelson (1996) to one that now suggests that national banks have no obligation to comply with any state laws except where Congress or the OCC has specifically directed them to do so.

A proposed standard that considers mere inconvenience to a bank as a conflict between federal and state law and gives the OCC sole discretion in determining whether a conflict exists is unacceptable. In our view, it runs directly counter to the expressed intent of Congress as clearly enunciated both in broad legislation addressing the interstate operations of national banks and in specific statutes dealing with the problem of predatory lending.

In enacting the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal Act"), Congress explicitly recognized and encouraged the application of state laws to the business operations of national banks and limited the circumstances permitting federal preemption. Congress included specific language (at 12 USC §36(f)) stating that "the laws of the host State regarding community reinvestment, consumer protection, fair lending, and establishment of interstate branches shall apply to any branch in the host State of an out-of-state national bank to the same extent as such State laws would have with respect to branches of a bank chartered by the host State." Preemption of such laws would be permitted only where a "Federal law" specifically preempted their application to a national bank or in the limited circumstances where the Comptroller determines that a state law has the effect of discriminating against an out-of-state branch in favor of a local state-chartered bank.

The House-Senate Conference Report for Riegle-Neal was equally explicit in recognizing the important role of states in regulating the operations of banks within their borders and acknowledging that preemption should be the exception rather than the rule. "States have a legitimate interest in protecting the rights of their consumers, businesses and communities," and the Congress "does not intend that the [Riegle-Neal] Act of 1994 alter and thereby weaken States' authority to protect the interest of their consumers, business and communities." The report also stated clearly, "Under well-established judicial principles, national banks are subject to State law in many significant respects....Courts generally use a rule of construction that avoids finding a conflict between the Federal law and State law where possible. This title does not change these judicially established principles."

The Conference Report went on to criticize the OCC for its failure to adhere to these established judicial principles and to cite several prior instances where the OCC's actions had been "inappropriately aggressive, resulting in preemption of State law in situations where the federal interest did not warrant that result." To prevent similar future actions, Riegle-Neal also amended the National Bank Act to subject the OCC to public notice-an-comment procedures prior to rendering future opinions on state laws. "In view of the Congressional concern regarding preemption of State law," the conferees described the public notice procedures as "a

vital safeguard to ensure that an agency applies the recognized principles of preemption....in a balanced fashion." The Report made it clear, however, that the notice-and-comment procedure was "not intended to confer upon the agency any new authority to preempt or to determine preemptive Congressional intent in the....areas described, or to change the substantive theories of preemption as set forth in existing law."

In a specific statute addressing the problem of predatory lending, the Home Ownership and Equity Protection Act of 1994 (HOEPA), Congress was clear in recognizing the state role in regulating bank lending practices within the specific context of high-cost mortgage-related credit transactions. Since HOEPA amended the 1968 Consumer Credit Protection Act (TILA), it was already subject to a federal preemption standard that recognized the right of states to enact laws requiring additional disclosures in connection with credit transactions, except where these requirements were inconsistent with the federal law. However, Congress sought to reiterate that state laws should continue to apply within the context of high-cost mortgage lending by adding duplicate language emphasizing that the provisions applying to high-cost mortgage-related transactions "do not annul, alter, or affect the applicability of the laws of any State or exempt any person subject to the provisions...from complying with the laws of any State....except to the extent that those State laws are inconsistent with any provision...and then only to the extent of the inconsistency." Importantly, the preemption provision in section 111 of TILA, and applicable to HOEPA, gives the Federal Reserve Board, not the OCC, the authority to determine whether any such inconsistency exists.

The OCC appears to be pursuing a conscious strategy of preemption that increasingly permits national banks, as well as any national bank operating subsidiary – whether bank or non-bank – to disregard most state laws and ignore virtually any request or directive of state banking regulators. The agency is proposing that it have the exclusive authority (except where otherwise provided by Federal law) to assess the applicability of state law and to determine and enforce compliance by national banks for any state law that is deemed applicable.

We are concerned that this has already encouraged a number of mortgage bank operating subsidiaries to challenge the legitimate authority of state regulators and turn in their state licenses. Preemption of state licensure requirements, including the ability to license and examine mortgage lending entities, is not sound public policy. Moreover, the OCC approach may even encourage institutions to refuse to pay consumer restitution ordered in settlement agreements with state officials. The settlement reached between the state attorneys general and Household International, for example, exposed serious predatory lending abuses and produced the largest amount ($484 million) of consumer restitution in our nation's history. Household could virtually ignore its obligations under this settlement under the OCC's claim of exclusive authority to regulate all aspects of real estate lending by national banks and any non-depository mortgage lending subsidiaries.

Eliminating the examination and enforcement resources that state officials currently provide to deter predatory lending will only protect predatory lenders and expose more consumers to future abuse. And such highly publicized conflicts, like that recently between

Wells Fargo & Co. and the California Department of Corporations, will do little to enhance the public's perception of the stability and safety of national banks and our overall banking system.

Federal regulators are under an obligation to assure that federal institutions comply with all applicable federal and state banking and consumer laws, not encourage institutions to ignore or evade them. The OCC's use of terms such as "impairment of efficiency" or "frustration of purpose" as potential criteria for voiding state laws in the recent notice of proposed rule-making is unacceptable.

We urge the OCC, at a minimum, to return to the preemption analysis standards of Barnett, which it enunciated so clearly in March 2002, that require that a state law "forbid" or "impair significantly" the conduct of an authorized federal activity as a prerequisite for preemption. We would also urge the OCC not to initiate the kind of unwarranted and "inappropriately aggressive" preemptions of state law that drew serious Congressional criticism in the Conference Report on the Riegle-Neal Interstate Banking bill. The contemplated preemption of predatory lending laws at this time will only encourage further abuse of consumers and could result in Congress having to act, as it did in 1994, to curb the OCC's preemption authority.

Sincerely,

Barney Frank

Wm. Lacy Clay

[illegible]

Barbara Lee

[illegible]

Carolyn B Maloney

[illegible]

[illegible]

[illegible]

Carolyn McCarthy

[illegible]

[illegible]

[illegible]

Maxine Waters

[illegible]

Ron Paul

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

April 3, 2003

The Honorable John D. Hawke, Jr.
Comptroller of the Currency
250 E. Street, SW
Washington, DC 21219

Dear Mr. Hawke:

It has come to our attention that the Office of the Comptroller of the Currency (OCC) has given notice of its intent to issue an advisory opinion on the applicability of the Georgia Fair Lending Act to national banks and their operating subsidiaries. It is also our understanding that your office may use the opportunity of the advisory opinion to enunciate a broad theory of federal law preemption that might not only nullify the Georgia statute, but could broadly impact all other State laws and regulations seeking to address the problem of predatory mortgage lending.

We believe that such action would violate a clear Congressional directive that States be permitted to augment federal law with more meaningful consumer protections and will needlessly expose millions of vulnerable consumers to abusive lending practices.

The extraordinary growth of subprime mortgage lending over the past decade has made credit and home ownership opportunities available to millions of lower income and minority consumers. Expanding access to credit for such consumers is a goal we've long advocated and continue to pursue. Unfortunately, it has also created what a 2000 Treasury-HUD joint report described as "fertile ground" for a variety of abusive practices that we collectively refer to as predatory lending. In recent years these practices--including deceptive marketing, undisclosed fee charges, excessive penalties and repeated refinancing of unaffordable debt–have stripped millions of hard working families of their equity, their savings and their homes. In areas with high concentrations of predatory loans, the impact goes beyond individual families to devastate entire neighborhoods and undermine the vitality of surrounding communities.

Many states have acted to protect consumers against these predatory practices. Beginning with North Carolina in 1999, at least eight states have enacted comprehensive statutes or regulations aimed at stopping predatory practices. Legislatures in two additional states, New Jersey and New Mexico, have also passed very strong predatory lending statutes that will soon be signed into law. State officials across the Nation have worked to alert the public to the problem of predatory lending and to educate consumers on how to avoid being victimized. These laws and regulations were a response to broad public campaigns, were approved with bipartisan support and were signed and implemented by Democratic and Republican Governors.

Unfortunately, the added consumer protections in these state laws and regulations would be swept away under the broad preemption scheme now reportedly envisioned by the OCC. Over the past year the OCC appears to have moved dramatically from a position that acknowledged the limitations on federal law preemption enunciated by the Supreme Court in Barnett Bank v. Nelson (1996) to one that now suggests that national banks have no obligation to comply with any state laws except where Congress or the OCC has specifically directed them to do so.

A proposed standard that considers mere inconvenience to a bank as a conflict between federal and state law and gives the OCC sole discretion in determining whether a conflict exists is unacceptable. In our view, it runs directly counter to the expressed intent of Congress as clearly enunciated both in broad legislation addressing the interstate operations of national banks and in specific statutes dealing with the problem of predatory lending.

In enacting the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal Act"), Congress explicitly recognized and encouraged the application of state laws to the business operations of national banks and limited the circumstances permitting federal preemption. Congress included specific language (at 12 USC §36(f)) stating that "the laws of the host State regarding community reinvestment, consumer protection, fair lending, and establishment of interstate branches shall apply to any branch in the host State of an out-of-state national bank to the same extent as such State laws would have with respect to branches of a bank chartered by the host State." Preemption of such laws would be permitted only where a "Federal law" specifically preempted their application to a national bank or in the limited circumstances where the Comptroller determines that a state law has the effect of discriminating against an out-of-state branch in favor of a local state-chartered bank.

The House-Senate Conference Report for Riegle-Neal was equally explicit in recognizing the important role of states in regulating the operations of banks within their borders and acknowledging that preemption should be the exception rather than the rule. "States have a legitimate interest in protecting the rights of their consumers, businesses and communities," and the Congress "does not intend that the [Riegle-Neal] Act of 1994 alter and thereby weaken States' authority to protect the interest of their consumers, business and communities." The report also stated clearly, "Under well-established judicial principles, national banks are subject to State law in many significant respects....Courts generally use a rule of construction that avoids finding a conflict between the Federal law and State law where possible. This title does not change these judicially established principles."

The Conference Report went on to criticize the OCC for its failure to adhere to these established judicial principles and to cite several prior instances where the OCC's actions had been "inappropriately aggressive, resulting in preemption of State law in situations where the federal interest did not warrant that result." To prevent similar future actions, Riegle-Neal also amended the National Bank Act to subject the OCC to public notice-an-comment procedures prior to rendering future opinions on state laws. "In view of the Congressional concern regarding preemption of State law," the conferees described the public notice procedures as "a

vital safeguard to ensure that an agency applies the recognized principles of preemption....in a balanced fashion." The Report made it clear, however, that the notice-and-comment procedure was "not intended to confer upon the agency any new authority to preempt or to determine preemptive Congressional intent in the....areas described, or to change the substantive theories of preemption as set forth in existing law."

In a specific statute addressing the problem of predatory lending, the Home Ownership and Equity Protection Act of 1994 (HOEPA), Congress was clear in recognizing the state role in regulating bank lending practices within the specific context of high-cost mortgage-related credit transactions. Since HOEPA amended the 1968 Consumer Credit Protection Act (TILA), it was already subject to a federal preemption standard that recognized the right of states to enact laws requiring additional disclosures in connection with credit transactions, except where these requirements were inconsistent with the federal law. However, Congress sought to reiterate that state laws should continue to apply within the context of high-cost mortgage lending by adding duplicate language emphasizing that the provisions applying to high-cost mortgage-related transactions "do not annul, alter, or affect the applicability of the laws of any State or exempt any person subject to the provisions...from complying with the laws of any State....except to the extent that those State laws are inconsistent with any provision...and then only to the extent of the inconsistency." Importantly, the preemption provision in section 111 of TILA, and applicable to HOEPA, gives the Federal Reserve Board, not the OCC, the authority to determine whether any such inconsistency exists.

The OCC appears to be pursuing a conscious strategy of preemption that increasingly permits national banks, as well as any national bank operating subsidiary – whether bank or non-bank – to disregard most state laws and ignore virtually any request or directive of state banking regulators. The agency is proposing that it have the exclusive authority (except where otherwise provided by Federal law) to assess the applicability of state law and to determine and enforce compliance by national banks for any state law that is deemed applicable.

We are concerned that this has already encouraged a number of mortgage bank operating subsidiaries to challenge the legitimate authority of state regulators and turn in their state licenses. Preemption of state licensure requirements, including the ability to license and examine mortgage lending entities, is not sound public policy. Moreover, the OCC approach may even encourage institutions to refuse to pay consumer restitution ordered in settlement agreements with state officials. The settlement reached between the state attorneys general and Household International, for example, exposed serious predatory lending abuses and produced the largest amount ($484 million) of consumer restitution in our nation's history. Household could virtually ignore its obligations under this settlement under the OCC's claim of exclusive authority to regulate all aspects of real estate lending by national banks and any non-depository mortgage lending subsidiaries.

Eliminating the examination and enforcement resources that state officials currently provide to deter predatory lending will only protect predatory lenders and expose more consumers to future abuse. And such highly publicized conflicts, like that recently between

Wells Fargo & Co. and the California Department of Corporations, will do little to enhance the public's perception of the stability and safety of national banks and our overall banking system.

Federal regulators are under an obligation to assure that federal institutions comply with all applicable federal and state banking and consumer laws, not encourage institutions to ignore or evade them. The OCC's use of terms such as "impairment of efficiency" or "frustration of purpose" as potential criteria for voiding state laws in the recent notice of proposed rule-making is unacceptable.

We urge the OCC, at a minimum, to return to the preemption analysis standards of Barnett, which it enunciated so clearly in March 2002, that require that a state law "forbid" or "impair significantly" the conduct of an authorized federal activity as a prerequisite for preemption. We would also urge the OCC not to initiate the kind of unwarranted and "inappropriately aggressive" preemptions of state law that drew serious Congressional criticism in the Conference Report on the Riegle-Neal Interstate Banking bill. The contemplated preemption of predatory lending laws at this time will only encourage further abuse of consumers and could result in Congress having to act, as it did in 1994, to curb the OCC's preemption authority.

Sincerely,

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[illegible]	[illegible]
Barbara Lee	Melvin L. Watt
Jay Inslee	[illegible]
Carolyn B Maloney	Maxine Waters
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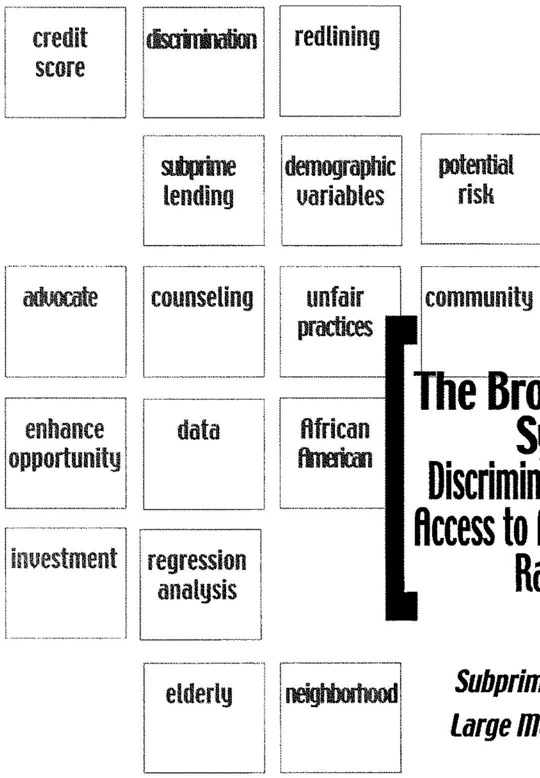

[The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age]

Subprime Lending in Ten Large Metropolitan Areas

The National Community Reinvestment Coalition

The National Community Reinvestment Coalition (NCRC) is the nation's trade association for economic justice whose members consist of local community based organizations. Since its inception in 1990, NCRC has spearheaded the economic justice movement. NCRC's mission is to build wealth in traditionally underserved communities and bring low- and moderate-income populations across the country into the financial mainstream. NCRC members have constituents in every state in America, in both rural and urban areas.

The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication and serve as a resource to all of us in the public and private sector who are committed to responsible lending. For more information, please contact:

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Table of Contents

Acknowledgements 2
Executive Summary 4
Recommendations 10
Background and Literature Review 19
Methodology 24
Data and variables 27
Impact of Demographic Versus Economic Factors 31
Metropolitan Areas Compared 34
Functional Form 36
Conclusion 37
Appendix 37
Table 1: Detailed Regressions for Atlanta 43
Table 2: Detailed Regressions for Baltimore 44
Table 3: Detailed Regressions for Cleveland 45
Table 4: Detailed Regressions for Detroit 46
Table 5: Detailed Regressions for Houston 47
Table 6: Detailed Regressions for Los Angeles 48
Table 7: Detailed Regressions for Milwaukee 49
Table 8: Detailed Regressions for New York 50
Table 9: Detailed Regressions for St. Louis 51
Table 10: Detailed Regressions for Washington, D.C. 52
Table 11: Summary of Regression Results 53
Table 12: Impact of Number of African-Americans in a Neighborhood 54
Table 13: Impact of Number of Hispanics in a Neighborhood 55
Table 14: Impact of Number of Elderly Residents in a Neighborhood 56

Executive Summary

The credit system is broken and discrimination is widespread in America. NCRC finds that African-American and predominantly elderly communities receive a considerably higher level of high cost subprime loans than is justified based on the credit risk of neighborhood residents. President Bush has declared an Administration's goal of 5.5 million new minority homeowners by the end of the decade. The widespread evidence of price discrimination, however, threatens the possibility of creating sustainable and affordable homeownership opportunities for residents of traditionally underserved neighborhoods.

The widespread evidence of price discrimination threatens the possibility of creating sustainable and affordable homeownership opportunities . . .

A subprime loan has an interest rate higher than prevailing and competitive rates in order to compensate for the added risk of lending to a borrower with impaired credit. NCRC defines a predatory loan as an unsuitable loan designed to exploit vulnerable and unsophisticated borrowers. Predatory loans are a subset of subprime loans. A predatory loan has one or more of the following features: 1) charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections, 2) contains abusive terms and conditions that trap borrowers and lead to increased indebtedness, 3) does not take into account the borrower's ability to repay the loan, and 4) violates fair lending laws by targeting women, minorities and communities of color. Using the best available industry data on credit worthiness, NCRC uncovered a substantial amount of predatory lending involving rampant pricing discrimination and the targeting of minority and elderly communities.

Sadly, it is still the case in America that the lending marketplace is a dual

marketplace, segmented by race and age. If a consumer lives in a predominantly minority community, he or she is much more likely to receive a high cost and discriminatory loan than a similarly qualified borrower in a white community. At the same time, the elderly, who have often built up substantial amounts of equity and wealth in their homes, are much more likely to receive a high cost refinance loan than a similarly qualified younger borrower. The disproportionate amount of subprime refinance lending in predominantly elderly neighborhoods imperils the stability of long-term wealth in communities and the possibilities of the elderly passing their wealth to the next generation.

Lending discrimination in the form of steering high cost loans to minorities and elderly borrowers qualified for market rate loans results in equity stripping and has contributed to inequalities in wealth. According to the Federal Reserve Survey of Consumer Finances, the median value of financial assets was $38,500 for whites, but only $7,200 for minorities in 2001. Whites have more than five times the dollar amount of financial assets than minorities. Likewise the median home value for whites was $130,000 and only $92,000 for minorities in 2001.[1]

This report confirms Americans' perceptions of bias in lending. In the winter of 2002, NCRC hired Republican pollster Frank Luntz and Democratic pollster Jennifer Laszlo Mizrahi to conduct a nationally representative poll of Americans' views of lending institutions. In the poll, fully 76 percent of Americans believed that steering creditworthy minorities and women to costly loan products was a significant problem. About 47

[1] Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, Federal Reserve Bulletin, January 2003.

percent of the survey respondents believed that a white man would be more likely than an African-American man with the same credit history to be approved for a loan. Only 10 percent of the respondents believed that the African-American would be more likely to be approved for a loan. Among African-American survey respondents, 74 percent thought the white man would be approved, and only 3.6 percent thought that a similarly qualified African-American would be approved over the white man. Unfortunately, this report verifies that these perceptions of discriminatory treatment are reality in too many instances.[2]

The single most utilized defense of lenders and their trade associations concerning bias is that credit scoring systems allow lenders to be color-blind in their loan decisions. This study, the largest and among the first of its kind, debunks that argument and clearly makes the case that African-American and elderly neighborhoods, regardless of the creditworthiness of their residents, receive a disproportionate amount of high cost subprime loans.

NCRC selected ten large metropolitan areas for the analysis: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington, D.C. As expected, the amount of subprime loans increased as the amount of neighborhood residents in higher credit risk categories increased. After controlling for risk and housing market conditions, however, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending. In particular:

[2] A Laszlo/Luntz Poll, conducted January 21 to February 13, 2002. Overall poll of 1,258 adults, margin of error 3.3%. Available via NCRC.

- The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas.

- The percent of African-Americans in a census tract had the strongest impact on subprime refinance lending in Houston, Milwaukee, and Detroit. Even after holding income, creditworthiness, and housing market factors constant, going from an all white to an all African-American neighborhood (100 percent of the census tract residents are African-American) increased the portion of subprime loans by 41 percentage points in Houston. For example, if 10 percent of the refinance loans in the white neighborhood were subprime, then 51 percent of the loans in an African-American neighborhood in Houston would be subprime. The portion of subprime refinance loans increased by 29, 26, and 20 percentage points in Milwaukee, Detroit, and Cleveland, respectively, from an all white to an all African-American neighborhood. Graph 1 provides details of this phenomenon across the metropolitan areas and shows a strong race factor in Atlanta, St. Louis, and Los Angeles as well.

- Solely because the percentage of the African-American population increased, the amount of subprime home purchase lending surged in Cleveland, Milwaukee, and Detroit. From an all white to an all African-American neighborhood in Cleveland, the portion of subprime home purchase loans climbed 24 percentage points. Graph 2 reveals that the portion of subprime purchase loans similarly rose by 18 and 17 percentage points in Milwaukee and Detroit, respectively, in African-American neighborhoods compared to white neighborhoods.

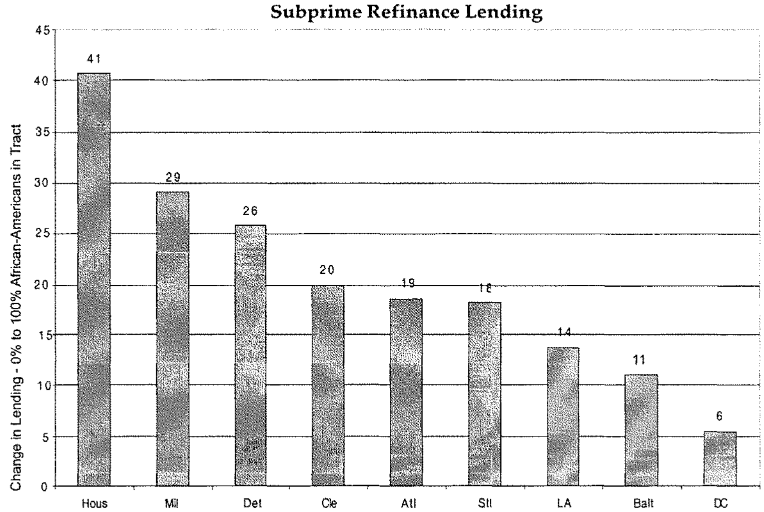
- The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood.

- Elderly neighborhoods experienced the greatest increases in subprime refinance lending in St. Louis, Atlanta, and Houston. Even after holding income, creditworthiness, and housing market factors constant, the portion of subprime refinance lending would surge 31 percentage points in St. Louis from a neighborhood with none of its residents over 65 to all of its residents over 65. Likewise, the increases were 27 and 25 percentage points in Atlanta and Houston, respectively. Although neighborhoods with such extreme age distributions (none or all residents over 65) are unusual, the regression analysis

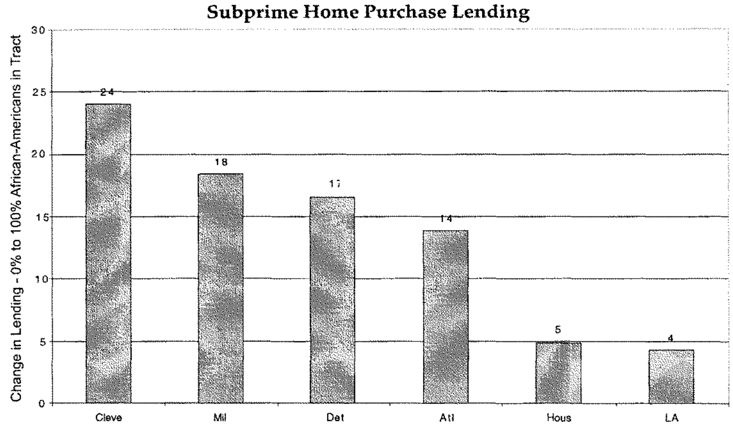
highlights and isolates the impacts of age on the level of subprime lending. Indeed, the level of subprime lending is likely to be considerably higher in neighborhoods with large concentrations of senior citizens.

- The level of subprime lending increased in a statistically significant fashion in the great majority of metropolitan areas as the percentage of neighborhood residents with no credit scores increased. Subprime refinance and home purchase lending climbed in nine and seven metropolitan areas, respectively, as the portion of neighborhood residents without credit scores increased. This is a significant issue for recent immigrants and other unbanked populations, many of whom are creditworthy for loans at prevailing interest rates, but receive high cost loans simply because they lack conventional credit histories.

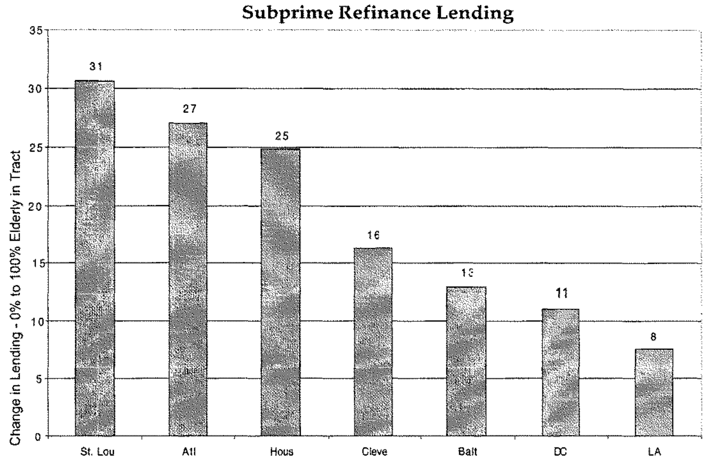
Graph 1: Index of Discrimination Against African-American Neighborhoods: Subprime Refinance Lending



Graph 2: Index of Discrimination Against African-American Neighborhoods: Subprime Home Purchase Lending



Graph 3: Index of Discrimination Against the Elderly: Subprime Refinance Lending



Recommendations

Legislative Recommendations

Reform FCRA to Mandate Complete and Accurate Credit Reports

As Congress renews the Fair Credit Reporting Act (FCRA), it must ensure that credit reports are complete and accurate. Anti-predatory lending bills introduced by members of Congress from both parties (Sarbanes and Ney) require creditors, once every three months, to provide a complete credit report and payment history to credit bureaus regarding all loans they made or serviced. A number of large subprime lenders currently withhold critical information regarding borrower on-time payments.[3] The practice of withholding information victimizes borrowers by trapping them in high cost loans and also victimizes lenders by reducing the overall reliability of the credit reporting system. A bipartisan consensus should be quickly achieved regarding this essential reform, yet the bipartisan House bill, HR 2622, does not contain this requirement. The FCRA bill proceeding in the Senate also does not require frequent reporting to the credit bureaus.

Our study also found that as the percent of neighborhood residents with no credit scores increases, so does the level of subprime lending. This is blatantly unfair since large numbers of consumers without traditional credit reports and credit scores are responsible and should qualify for loans at prevailing interest rates. One major reason why a large segment of consumers lack credit scores is that the credit reporting system does not capture non-traditional payment histories such as rental and utility

[3] Remarks by John D. Hawke, Jr., Comptroller of the Currency, Consumers Bankers Association Conference in San Francisco on June 7, 1999, available via http://www.occ.treas.gov.

payments. Congress must require the reporting of these two essential payment history items to the credit bureaus in order to reduce pricing discrimination and make the lending system fairer.

NCRC also recommends that an FCRA renewal bill requires additional studies on credit scoring and fund and promote nationwide financial education initiatives.

Comprehensive Anti-Predatory Legislation

Congress must enact comprehensive anti-predatory lending legislation along the lines of bills introduced by Senator Sarbanes and Representative Schakowsky. Comprehensive and strong anti-predatory lending legislation would eliminate the profitability of exploitative practices by making these practices illegal. It could also reduce the amount of price discrimination since fee packing and other abusive practices would be prohibited. A comprehensive anti-predatory law would also strengthen the Community Reinvestment Act (CRA) if regulatory agencies severely penalize lenders through failing CRA ratings when the lenders violate anti-predatory law.

Congress Must Pass a CRA Modernization Bill

In the 107th Congress, Representatives Luis Gutierrez and Thomas Barrett introduced HR 865, the CRA Modernization Act. This vital bill would increase the rigor of CRA exams by requiring the federal banking agencies to scrutinize the level of lending to minorities as well as low- and moderate-income borrowers. In addition, the CRA Modernization Act would expand CRA to cover independent mortgage companies and all non-depository affiliates of banks. Since price discrimination on the basis of race is prevalent, CRA must be used to prod lenders to offer more

prime loans at prevailing interest rates to minorities. At the same time, expanding CRA to large numbers of lenders would also result in an influx of affordable loans to traditionally underserved communities.

Enhance the Quality of HMDA Data

NCRC believes that Congress and the Federal Reserve Board (which implements the HMDA regulations) must enhance HMDA data so that regular and comprehensive studies can scrutinize fairness in lending. Specifically, are minorities, the elderly, women, and low- and moderate-income borrowers and communities able to receive loans that are fairly priced? While NCRC is confident in the findings of our study, we believe that more information in HMDA data is critical to fully explore the intersection of price, race, gender, and income. HMDA data must contain credit score information similar to the data used in this report. For each HMDA reportable loan, a financial institution must indicate whether it used a credit score system and if the system was their own or one of the widely used systems such as FICO (a new data field in HMDA could contain 3 to 5 categories with the names of widely-used systems). The HMDA data also would contain one more field indicating which quintile of risk the credit score system placed the borrowers.

Using this data, regulators, researchers, the media, and the public could determine if any of the credit score systems were placing minorities and other protected classes in the higher risk categories a disproportionate amount of time. The data would facilitate more econometric analysis to assess whether the prices of loans are based on risk, race, gender, or age. In addition, other critical underwriting variables are needed in the HMDA data including information on debt-to-income ratios and loan-to-value ratios.

Financial Education Critical, Especially for Populations Lacking Credit Scores

In the metropolitan areas examined, about 15 percent of the population lacked credit scores. The percentage was even higher in minority census tracts. A significant finding of this report is that consumers are more likely to receive subprime loans when they lack credit scores. Increased financial education initiatives by Congress, government at all levels, the private sector, and the nonprofit sector are necessary to reach out to the segment of the population that lack credit scores and/or are "unbanked." The segment of the population without credit scores is unlikely to have a fair chance at receiving affordable loans as long as they lack credit histories and remain outside the financial mainstream. In order for financial education to be universal, NCRC recommends that the Department of Education require basic financial literacy to be part of the curriculum of all public schools.

A significant finding of this report is that consumers are more likely to receive subprime loans when they lack credit scores.

Regulatory Recommendations

Federal Agencies Must Step Up Enforcement of Existing Laws to Promote Full Product Choice and Prevent Product Steering

Periodically, the Federal agencies regulating financial institutions will make great fanfare announcing a settlement of a major discrimination lawsuit or the publication of new "interagency" fair lending guidelines. The sad fact, however, is that federal agency efforts to eliminate discrimination and steering creditworthy borrowers to expensive products are failing. The agencies must step up their enforcement of the Equal Credit Opportunity Act, the Fair Housing Act, the Community Reinvestment Act and other fair lending laws in order to ensure full product choice for all Americans.

Halt Preemption of State Anti-Predatory and Consumer Protection Law

The Office of the Comptroller of the Currency (OCC) has preempted Georgia's anti-predatory law for large national banks and has proposed to preempt anti-predatory and consumer protection laws in all states. The OCC's proposed regulations are much weaker in combating abusive practices than state law that would be preempted. At the same time, the Office of Thrift Supervision (OTS) has been preempting anti-predatory law, one state at a time, for federally chartered thrifts. Given the evidence of widespread pricing discrimination, anti-predatory and consumer protection law at all levels need to be strengthened, not weakened. For many decades, banking laws have co-existed on a Federal and state level in many areas such as privacy and disclosures of mortgage terms. This is precisely the wrong time to wipe out critical state anti-predatory and consumer protection law. The credit system is broken, and needs more oversight, not less.

Anti-predatory and consumer protection law at all levels need to be strengthened, not weakened

Federal Reserve Board Must Step Up Anti-Discrimination and Fair Lending Oversight

The General Accounting Office concluded that the Federal Reserve Board has the authority to conduct fair lending reviews of affiliates of bank holding companies. The Federal Reserve Board, however, continues to insist that it lacks this authority.[4] This issue must be resolved because comprehensive anti-discrimination exams of all parts of bank holding companies are critical. Most of the major banks have acquired large subprime lenders that are then considered affiliates and become off-limits to Federal Reserve examination. A pressing question is the extent to

[4] General Accounting Office, *Large Bank Mergers: Fair Lending Review Could be Enhanced with Better Coordination*, November 1999, GAO/GGD-00-16.

which the subprime affiliates refer creditworthy customers to the prime parts of the bank so that the customers receive loans at prevailing rates instead of higher subprime rates. Or does the subprime affiliate steer creditworthy borrowers to high cost loans? These questions remain largely unanswered. Consequently, we do not know the extent to which steering by subprime affiliates and/or their parent banks contributed to the discrimination documented by this report. Thus, it is past time for the Federal Reserve to examine affiliates as well as the parent bank.

Increase Fair Lending Enforcement of Non-Bank Lending

CRA and fair lending reviews cover depository institutions. Large non-bank lenders comprise a significant segment of subprime lenders but are not covered by regular CRA exams and fair lending reviews. As far as we know, neither the Department of Housing and Urban Development, the Department of Justice, nor the Federal Trade Commission has established a proactive program to conduct fair lending investigations of large non-bank lenders. The Department of Justice has settled lawsuits regarding price discrimination with the Long Beach Mortgage Company and other institutions.[5] These lawsuits, however, are usually reactive and in response to complaints or referrals from other regulatory agencies. In cooperation with state regulatory agencies, NCRC calls upon federal agencies to undertake a proactive and aggressive program to enforce the fair lending laws in the case of non-bank lenders.

CRA Exams Must Scrutinize Non-Prime Lending More Rigorously

Currently, CRA exams are not adequately assessing the CRA performance

[5] Department of Justice settlement with Long Beach Mortgage Company, September 5, 1996.

of subprime lenders. For example, the CRA exam of the subprime lender, Superior Bank, FSB, called its lending innovative and flexible before that thrift's spectacular collapse.[6] If CRA exams continue to mechanistically consider subprime lending, subprime lenders will earn good ratings since they usually offer a larger portion of their loans to low- and moderate-income borrowers and communities than prime lenders.

At this point, the regulatory agencies have stated in an "Interagency Question and Answer" document that banks will be downgraded if their lending violates federal anti-predatory law. NCRC has not seen rigorous action to implement this guidance. Fair lending reviews that accompany CRA exams do not usually scrutinize subprime lending for compliance with anti-predatory law, for possible pricing discrimination, or whether abusive loans are exceeding borrower ability to repay. NCRC recommends that all CRA exams of subprime lenders must be accompanied by a comprehensive fair lending and anti-predatory lending audit. In addition, CRA exams must ensure that prime lenders are not financing predatory lending through their secondary market activity or servicing abusive loans.

NCRC also recommends that any bank or thrift whose subprime lending exceeds a nominal amount such as 5 percent of its total loan amount must have a separate prime and subprime CRA lending exam. As NCRC stated in our comment letter during the Advance Notice of Proposed Rulemaking on the CRA during the fall of 2001, a bank or thrift must not pass its lending test if it does not score at least a satisfactory rating on the

[6] Office of Thrift Supervision Central Region's CRA Evaluation of Superior Bank, FSB, Docket #: 08566, September 1999. Available via http://www.ots.treas.gov, go to the CRA search engine and select "inactive" for the status of the institution being searched.

prime portion of its lending test. The lending test is currently the most important part of CRA exams for large banks and the only element of small bank exams. Prime lending must likewise be elevated as the most important part of the lending test. NCRC's study contributes to a significant amount of evidence that minority communities receive too much subprime lending due to discrimination. In order to correct for market failure and increase product choice in underserved communities, NCRC believes that prime lending must be emphasized on CRA exams.

Full Disclosure of Automated Underwriting Systems

This report focused on the impact of credit scores as well as race and age composition of neighborhoods in determining the level of subprime lending. Automated underwriting systems use credit scores and variables similar to the ones in this report in guiding financial institutions in their lending decisions. Since our report found a substantial amount of price discrimination, we believe that automated underwriting systems must be made more transparent in order to assess whether they are contributing to discrimination. Factors and the weights of factors used by the automated systems must be disclosed. The Department of Housing and Urban Development must release the results of its fair lending examination of Fannie Mae's and Freddie Mac's automated underwriting systems.

Recommendations for Lenders, Community Groups, and Consumers

Lenders Must Adopt Risk-Based, Not Race-Based or Age-Based Pricing: Best Practices Needed

This report finds that discrimination on the basis of race and age is wide-

spread in America. Too many subprime lenders disregard risk, as measured by credit scores, in pricing their loans. NCRC calls upon the lending industry to adopt comprehensive best practices so that they can avoid pricing discrimination and other predatory practices. The best practices approach must also include rigorous compliance training for loan officers as well as mystery shopping and testing initiatives to identify and eliminate discriminatory practices. NCRC is in the process of completing a mystery shopper report that documents the need for additional industry compliance efforts because the report reveals disparate treatment regarding interest rate and loan terms for white and minority testers.

Community Groups Must Advocate and Offer Financial Education and Counseling Programs

NCRC's findings reinforce the need for community group advocacy as well as program delivery. Community groups must be active in the CRA process, offering comments during CRA exams and merger applications, particularly when they believe a lender is violating fair lending law and discriminating against minorities, women, and the elderly. Each time a community group and/or coalitions of community groups change the practices of a major lender (engaged in both prime and subprime lending), the impact on the industry as a whole is profound and cannot be underestimated. At the same time, community groups should continue pursuing programmatic opportunities, including mystery shopping, financial education, and counseling programs. Community groups should increase their skill and sophistication of using data compiled from their program delivery for their advocacy and policy positions.

Consumers Must Shop for Affordable Loans and Obtain Credit Reports, Credit Scores, and Pursue Inaccuracies

NCRC recommends that consumers consult with NCRC's *Best and Worst Lenders* at http://www.ncrc.org to find a list of lenders most likely to approve minorities, women, and low- and moderate-income consumers for affordable loans. *Best and Worst Lenders* provides detailed information on lenders in 25 major metropolitan areas. Consulting with *Best and Worst Lenders* increases the chances that consumers will be approved for loans. In addition, *Best and Worst Lenders* enables consumers to identify responsible banks that reinvest consumer deposits back into minority and low- and moderate-income communities instead of redlining local communities and investing their deposits elsewhere.

Once a year, consumers should also purchase their credit reports and scores from each major credit bureau (Experian at www.experian.com, Equifax at www.equifax.com; and Trans Union at www.transunion.com). If a consumer believes that his or her credit report contains an inaccuracy, he or she should ask the credit bureaus to investigate and correct any mistakes. If the consumer believes that the credit bureaus have not fairly resolved disputes over mistakes, he or she should contact the Federal Trade Commission at www.ftc.gov.

Background and Literature Review

NCRC benefited from industry data on creditworthiness in order to produce a comprehensive study on the relationship between loan pricing and the race and age of neighborhoods. NCRC used credit scoring data provided by one of the three large credit bureaus. A credit score is a numerical score estimating the chances a consumer will be delinquent in loan payments or default altogether. The credit score is derived from statistical analysis of information contained in credit reports regarding a

consumer's past payment history and use of credit. On a census tract level, the credit scoring data indicated how many consumers were in various categories of risk. NCRC was then able to analyze the impact of credit scores on the level of subprime home lending by combining the credit scoring information with the Home Mortgage Disclosure Act (HMDA) data, and demographic and housing stock data from the Census Bureau.

NCRC employed regression analysis to predict the level of subprime lending on a census tract level in ten large metropolitan areas. The analysis allowed NCRC to determine whether increases in the African-American, Hispanic, or elderly population in a neighborhood led to increases in the amount of subprime loans after controlling for credit-worthiness (as revealed by the credit score data) and important housing stock characteristics. As stated above, the findings revealed that minority and elderly neighborhoods do, in fact, receive substantially higher levels of subprime lending than is justified based on the creditworthiness of their residents, housing values, and other measures of housing market conditions.

NCRC's findings are consistent with a body of research on subprime lending. A recent survey study conducted by Freddie Mac analysts finds that two-thirds of subprime borrowers were not satisfied with their loans, while three-quarters of prime borrowers believed they received fair rates and terms.[7] In previous years, Freddie Mac and Fannie Mae have often been quoted as stating that between a third to a half of

[7] Freddie Mac analysts Marsha J. Courchane, Brian J. Surette, Peter M. Zorn, *Subprime Borrowers: Mortgage Transitions and Outcomes*, September 2002, prepared for Credit Research Center, Subprime Lending Symposium in McLean, VA.

borrowers who qualify for low cost loans receive subprime loans.[8] Dan Immergluck, a professor at Grand Valley State University, was one of the first researchers to document the "hypersegmentation" of lending by race of neighborhood.[9] Like Immergluck's work, the Department of Housing and Urban Development found that after controlling for housing stock characteristics and the income level of the census tract, subprime lending increases as the minority level of the tract increases.[10] The Research Institute for Housing America, an offshoot of the Mortgage Bankers Association, released a controversial study in 2000 which concluded that minorities were more likely to receive loans from subprime institutions, even after controlling for the creditworthiness of the borrowers.[11]

A recent survey study conducted by Freddie Mac analysts finds that two-thirds of subprime borrowers were not satisfied with their loans,

NCRC's study is quite similar and builds upon important research conducted by a Federal Reserve economist and two researchers from the Wharton School at the University of Pennsylvania. Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School also use credit scoring data to conduct econometric analysis scrutinizing the influence of credit scores, demographic characteristics, and economic conditions on the level of subprime lending. Their study found that after controlling for creditworthiness and housing market

[8] "Fannie Mae Vows More Minority Lending," in the Washington Post, March 16, 2000, page E01. Freddie Mac web page, http://www.freddiemac.com/corporate/reports/moseley/chap5.htm.

[9] Dan Immergluck, *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development*, the Woodstock Institute, November 1999.

[10] Randall M. Scheessele, *Black and White Disparities in Subprime Mortgage Refinance Lending*, April 2002, published by the Office of Policy Development and Research, the U.S. Department of Housing and Urban Development.

[11] Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why?* Working Paper No. 00-03, published by the Research Institute for Housing America, September 2000.

conditions, the level of subprime refinance and home purchase loans increased in a statistically significant fashion as the portion of African-Americans increased on a census tract level in Philadelphia and Chicago.[12]

Relatively few studies examine the relationship between the number of elderly residents of a neighborhood and the level of subprime lending although anecdotal evidence suggests that abusive lenders target the elderly. In one study, the South West office of Consumers Union found that every 1 percentage point increase in the portion of people over 65 in a neighborhood increased subprime refinance lending by 1.3 percentage points. The Consumers Union study examined neighborhoods in Dallas and Austin, and included demographic variables and a few underwriting variables such as loan amount to income ratios in its regression equations.[13] The AARP also conducted a national survey of elderly borrowers and found that older borrowers who were widowed, female, African-American, and less educated were more likely to receive subprime loans than their married, male, white, and more educated counterparts. The survey also found that seniors receiving subprime loans were more likely to have been approached by brokers, to have refinanced two or more times in the past three years, and to be dissatisfied with their loans.[14]

Another body of literature examines whether consumer credit reports are

[12] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov.

[13] Consumers Union, *Elderly in the Subprime Market*, October 2002, www.consumersunion.org.

[14] Neal Walters and Sharon Hermanson, *Older Subprime Refinance Mortgage Borrowers*, AARP Public Policy Institute, Data Digest Number 74, July 2002, http://www.aarp.org/ppi.

accurate. If consumer credit reports are incomplete and inaccurate, then the credit scores used to assess risk could be seriously flawed. Troubling evidence suggests that substantial inaccuracies exist in credit reports and could be contributing to racial disparities in lending. In the summer of 2002, the Consumer Federation of America (CFA) shed more light on how credit report flaws can disproportionately impact borrowers on the edge between prime and subprime credit. CFA's analysis of credit scores in more than 500,000 merged credit files revealed that 29 percent of consumers had scores with a range of at least 50 points when using the credit reports from each of the three major bureaus. Focusing in more detail on 1,704 at-risk mortgage purchasers with marginal scores between prime and higher cost subprime credit, CFA found that at least one-fifth would be harmed, and one-fifth would benefit from score inaccuracy if they tried to purchase mortgage loans. The upshot of this finding is that at least 8 million Americans may be erroneously placed into subprime loans and thus pay tens of thousands of dollars each in unnecessarily high mortgage interest payments.[15]

In the winter of 2003, a Federal Reserve Bulletin article revealed that almost one third of sampled credit accounts lacked information on borrower credit limits, which is a key variable for credit scores. Furthermore, subprime specialists reported credit limits 77 percent of the time for their prime customers, but only 40 percent of the time for their subprime customers.[16] Not reporting the credit limit makes borrower credit appear

[15] Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implication for Consumers*, December 2002, http://www.consumerfed.org.

[16] Robert B. Avery, Paul S. Calem, Glenn B. Canner, Raphael Bostic, *An Overview of Consumer Data and Credit Reporting*, Federal Reserve Bulletin, February 2003, http://www.federalreserve.gov.

to be much worse than it actually is. The absence of this information results in borrowers appearing to be much closer to fully utilizing their credit cards and other open ended credit than they are in reality.

The findings of NCRC, the Calem, Gillen, and Wacther study, as well as other research, are disturbing but not surprising. Predatory lenders brazenly disregard credit scores and also do not engage in other conventional and prudent underwriting techniques. They discriminate by offering minority and elderly borrowers higher interest rate loans than is justified based on credit scores. At the same time, credit scores are not accurately predicting risk due to omitted variables that are key for traditionally underserved populations. In short, the credit system is broken and discrimination will only be eliminated if the recommendations outlined above are implemented.[17]

Methodology

As stated above, the key goal of the analysis is to determine the relationship between the portion of minority and elderly persons in a census tract and the percentage of home purchase and refinance loans that are made by subprime lenders. After controlling for economic and risk factors, does the portion of subprime loans increase as the minority and elderly population in a census tract increases? In other words, this study explores the likelihood of discrimination and reverse redlining in home

[17] Given the problems with credit reports, the credit scores used here are more likely to overstate risks for minority borrowers than for white borrowers. Accordingly, the scores are more likely to overstate the percent of borrowers in high risk groups in African-American rather than white census tracts. If such bias does occur in scores, then the use of these scores means that the true impact of race on subprime lending is higher than that indicated by the results found here. That is, our estimates of discrimination or redlining are biased low. The credit report and score data needs to be improved via renewal of Fair Credit Reporting Act.

lending. NCRC chose 10 metropolitan statistical areas (MSAs) from different parts of the United States and conducted a statistical analysis in each area. In particular, the MSAs selected are: Atlanta, Baltimore, Cleveland, Detroit, Houston, Los Angeles, Milwaukee, New York, St. Louis, and Washington DC. These areas have different demographic and economic characteristics, which will allow us to make credible and generalizable conclusions about the home lending patterns across large metropolitan areas. In the ten MSAs, the sample consists of about 7,000 census tracts (6,741 for home purchase and 7,097 for refinance). A multivariate regression approach controlled for demographic and risk factors.

NCRC conducted separate analyses for home purchase and refinance lending. We expected a higher degree of pricing disparities by race and age of neighborhood in refinance lending since subprime lenders specialize in refinance lending and make fewer home purchase loans. NCRC's previous work, including *Best and Worst Lenders*, also found more disparities in refinance lending than home purchase lending. Abusive subprime lenders are particularly active in refinance lending since their intention is to strip equity from homeowners through repeated refinancings or flipping.

Variables for the analysis belong to three categories: home lending, credit scoring, and demographics. NCRC used 2001 HMDA data for home lending, 1999 credit scoring data, and 1990 census tract demographic information. NCRC obtained the 1999 credit scoring data on a one-time basis from one of the three large credit bureaus. NCRC chose 2001 HMDA data, not 1999 data, as we believe that the distribution of credit scores on a census tract level does not vary significantly over a three year time period. NCRC ran regression equations using 1999 and 2000 home

loan data to confirm the hypothesis. The results were similar over the years. Also, 2001 was a year of lower interest rates. NCRC wanted to see if minority neighborhoods were benefiting from lower interest rates as measured by a decrease in the statistical significance of race of neighborhood on the level of subprime lending. NCRC would have preferred to use 2000 census tract data, but the HMDA data will not use 2000 census data until the 2003 release in the summer of 2004. The 2001 HMDA data uses 1990 census tract boundaries. NCRC believes the results will be similar with HMDA data using 2000 census tract boundaries, but we intend to do follow-up research.[18]

HUD Subprime and Manufactured Home Lender List

In order to classify loans as subprime, NCRC used a list of subprime and manufactured home lenders developed by HUD. Since HMDA data does not have information on the Annual Percentage Rate (APR) or other loan terms and conditions, HUD developed its list by complementing data analysis with interviews of lending institutions and a literature search. As an additional step, HUD called the lenders on its list and asked them if they considered themselves subprime and manufactured home specialists. Generally speaking, a lender was included on the list if more than 50 percent of the loans in its portfolio was subprime or manufactured home.[19]

[18] Important characteristics of the HMDA data are discussed separately in an appendix.

[19] HUD itself admits that the list is not complete. A number of institutions considered to be prime specialists make a significant number of subprime loans, even if 50 percent or more of their loans are not subprime. Also, the list may not be complete due to name changes and omissions. HUD refines its lists on an annual basis and also corrects mistakes on previous years' lists. HUD's web page (http://www.huduser.org/datasets/manu.html) has more information about the lists and has copies of the lists.

Until more information on loan terms and conditions are available in HMDA data, HUD's list is a valuable resource for conducting subprime and manufactured home loan analysis. Although the list is incomplete, it still captures significant differences in lending behavior as revealed by this report and a substantial body of research.

Data and variables

Home lending data in the analysis represents only originations of home loans, not applications for the loans. We included all types of loans: conventional, and government insured (FHA, VA, and FSA/RHS) to owner-occupants only. NCRC also separated two types of home loans: home purchase loans and refinance loans. By doing so, we aimed to see for which loan type the race and age of neighborhood residents had a stronger influence. We excluded manufactured home lenders from the analysis as initial regressions revealed that the level of manufactured home lending did not vary in a statistically significant manner with the race of neighborhood residents.[20] Future research should explore this in more detail. The study excluded census tracts in which the number of originated loans was less than 20. This was done to ensure a sufficient number of loans for meaningful characterization of each tract's lending patterns.

[20] Manufactured home lenders specialize in making loans to borrowers purchasing manufactured homes. These lenders tend to make high interest rate loans; abusive lending has been widespread in the manufactured home sector as indicated by massive foreclosures and the failures of large national manufactured home lenders. According to HUD, "A manufactured home (formerly known as a mobile home) is built to the Manufactured Home Construction and Safety Standards (HUD Code) and displays a red certification label on the exterior of each transportable section. Manufactured homes are built in the controlled environment of a manufacturing plant and are transported in one or more sections on a permanent chassis." HUD has detailed information about manufactured housing on its web page of http://www.hud.gov.

The analysis chose the following variables that would hypothetically influence subprime lending in an area.

Home lending variables (dependent variables):

%subHP – percent of home purchase loans in a census tract that were subprime.

%subREF – percent of refinance loans in a census tract that were subprime.

Demographic variables included:

%black – percent of residents in a census tract who were African-American;

%hisp – percent of residents in a census tract who were Hispanic;

%65age – percent of residents in a census tract who were over 65 years old;

medage – dummy variable. The variable revealed the median age of houses in a census tract.

0 when the median age of housing was between 0-20 years old (built in 1970-1990);
1 when the median age of housing was between 21-50 years old (built in 1969-1940);
2 when the median age of housing was 51 years and older (built before 1940);

medhhinc – 1989 median household income in a census tract;

HT – housing turnover. This variable is a ratio of all home purchase loans made in 2001 divided by owner occupied units in 1990. The literature indicates that a higher amount of housing turnover (as revealed by larger values of this variable) suggests a more vibrant market and faster home value appreciation. This should make a census tract more attractive to prime lenders and thus decrease the portion of subprime lending.

capitaliz – The "capitalization" variable is a ratio of gross median rent divided by median housing value. The literature suggests that owner-occupied units appreciate slower in neighborhoods where the median rent is higher relative to the median housing value (higher ratio values for this variable). Therefore, prime lenders may find neighborhoods less attractive with higher values for the capitalization variable, meaning that the portion of subprime loans will be higher in these neighborhoods.

Credit scoring variables included:

%vhigh – is a credit score variable that indicated the percent of people in a census tract in the very high credit risk category;

%NC – is the percent of neighborhood residents lacking credit scores;

vh+h+m – the cumulative percent of neighborhood residents in very high, high, and moderate credit risk categories added together.

The credit risk scores used in this report measure the likelihood of future delinquencies and foreclosures. The database had a credit score range from 0 to 1,000 with lower scores indicating lower risk or chance of borrower delinquency. The scores were divided into five equal categories or quintiles of risk; the specific categories are Very Low, Low, Moderate, High and Very High risk. The credit score range was separated into quintiles, not the population totals within the quintiles. In other words, each score quintile did not have equal numbers of people, but each score range was of equal length (about 200 units for each quintile since the total range is from 0 to 1,000).

For each census tract, the database contains the number and percent of neighborhood residents in each of the five risk categories, and the number and percent of neighborhood residents with no credit scores.

NCRC's analysis focuses on the "vh+h+m" credit score variable. Our regression analysis was iterative. One equation (Column 1 on Tables 1 through 10) included the combined risk variable of "vh+h+m" and the NC or no credit score variable. Column 2 is another regression in which the very high risk and no credit score variables are included as separate variables (see the tables below).

Columns 3 through 4 repeat the iterative approach for the risk variables in the same order as Columns 1 through 2. The difference between Columns 1 and 2 and Columns 3 and 4 is that the race and age variables are omitted in Columns 3 and 4. This is done in order to understand better the added explanatory power obtained by including the race and age variables (see discussion below in the Functional Form section).

The "vh+h+m" variable was statistically significant across all ten MSAs for home purchase lending and nine MSAs for refinance lending. The impact of the variable was as expected; that is, subprime lending was more prevalent as the percentage of people in a census tract with very high, high, and moderate risk increased. The regression equations including only the very high risk and no credit score variables had very similar outcomes to the equations with the "vh+h+m" combined risk and no credit score variables. Although the very high risk equations (Column 2) were similar to the "vh+h+m" equations (Column 1), we focused on the "vh+h+m" equations since subprime lenders would likely make loans to consumers with high and moderate risk as well as very high risk. The coefficients and R squares in the "vh+h+m" equations were consistent with these expectations.

In contrast to our report, the Calem, Gillen, and Wacther study focuses on the equations with the very high risk and no credit score variables. The fact that two different series of equations (those with very high risk and no credit score variables and those with the combined risk and no credit score variables) produced similar results adds to the robustness of the overall findings.

Impact of Demographic Versus Economic Factors

As stated above, we conducted multivariate regression analysis with the dependent variable represented by the percentage of subprime loans in a census tract and independent variables that control for demographic, economic and risk factors. Our variables of interest were the minority and elderly populations in a census tract. NCRC hypothesized that the percent of minorities and elderly people in a census tract was positively related to the percent of subprime loans originated in a census tract.

. . . the percent of minorities and elderly people in a census tract was positively related to the percent of subprime loans originated in a census tract.

Table 11 shows the statistical significance of variables at the 10%, 5%, and 1% precision level, sign of estimated coefficients, and adjusted R square for every regression. The adjusted R square was rather high for most MSAs and loan types (the higher the R square, the better the equation accounts for and explains patterns of subprime lending on a neighborhood level). The R square was higher for refinance than home purchase, suggesting that our model was better at predicting patterns in refinance lending. For refinance lending, the R square ranged from 0.5252 in Los Angeles to 0.8993 in Detroit. For home purchase lending, the R square fell between 0.0843 in Baltimore and 0.6865 in Cleveland. The R square was above 0.3 in five out of ten MSAs in home purchase lending. In contrast, the R square was above 0.3 in all MSAs in refinance lending. Overall, we believe our model is robust and a good predictor of lending patterns. The model's results were consistent with the Calem, Gillen, and Wachter study.

The African-American population in a census tract was statistically significant in six MSAs for home purchase lending and in nine MSAs for

refinance lending. As expected, after controlling for risk and housing stock characteristics, the effect of the percentage of African-American population on the portion of subprime loans in a census tract was positive in all MSAs. Lenders still associated high risk with race and thus, compensated by making a substantially higher level of subprime loans in African-American than white tracts.

The percent of Hispanic population in a census tract was significant in only one MSA for home purchase and in five MSAs for refinance lending. The sign of the coefficients was not consistent for each MSA.[21] The sign was negative in one MSA for home purchase lending and in two MSAs for refinance lending. In contrast, the sign was positive in three MSAs for refinance lending, meaning that the level of subprime refinance lending increased as the portion of Hispanics increased in a census tract. Our study results suggest no consistent relationship between the level of subprime lending and the portion of Hispanics in a neighborhood. However, the portion of Hispanics in a neighborhood was associated with an increase in subprime lending, all else equal, in a subset of the MSAs.

The portion of people over 65 was a strong factor for three out of ten MSAs for home purchase lending. For refinance lending, the age of the census tract population was significant in eight MSAs. For refinance and

[21] A coefficient expresses the effect of an independent variable on the dependent variable. In this report, the portion of subprime loans is the dependent variable. The level of subprime lending changes because of the racial composition of the neighborhood and other "independent" variables. For the racial composition of the neighborhood, the coefficient measures the impact in percentage point terms. For every percentage point increase in African-American or Hispanic residents in a census tract, the portion of subprime loans increases or decreases by a certain number of percentage points as revealed by the value and sign of the coefficient. The coefficient only has an impact if it is statistically significant (as revealed by legends in the charts capturing the regression results).

home purchase lending, the sign of the coefficients was positive in all MSAs except in two of the eleven cases. This supports the contention that abusive lenders target the elderly to take advantage of the fact that the elderly have substantial amounts of equity but are often short on cash. These results contradict those obtained by Calem, Gillen, and Wachter. They mentioned that this variable "yielded no additional insights," but their study looked at only two MSAs.

Median household income of a census tract was statistically significant in four out of ten MSAs in home purchase lending and in refinance lending. Except in one case, the sign of the coefficients was positive, which is counterintuitive. The literature, however, discusses that a segment of high income borrowers do not report income level to lenders nor do they want to undergo a lengthy application process. Hence, they receive subprime loans. It must be added that the coefficient values were very small, meaning that the income variable had a small impact on the level of subprime lending in census tracts.

Except for Detroit refinance lending, the combined risk variable in all MSAs for both loan types was statistically significant. Coefficients were positive, meaning that a larger percentage of people with higher risk factors was associated with a higher percent of subprime loans in a census tract. These findings are quite consistent with those discussed in the Calem, Gillen, and Wachter report. Also, the level of subprime home purchase and refinance lending increased in a statistically significant fashion in the great majority of MSAs as the percentage of neighborhood residents with no credit scores increased.

The other variables including housing turnover and capitalization be-

haved in the expected manner. Housing turnover was significant in most MSAs and the coefficients' signs were negative, which supported our expectations. Higher housing turnover indicates more vibrancy in the market of the neighborhood, which in turn leads to less subprime lending. The capitalization variable was significant in six MSAs for home purchase and in ten MSAs for refinance lending. Except in one case, it also had the expected effect on subprime lending. Specifically, it was positively related to the percent of subprime loans, proving that faster appreciation of the owner-occupied units (smaller capitalization ratios) leads to less subprime lending in a neighborhood.

Subprime lending increased significantly as the portion of African-Americans and elderly people increased in a neighborhood.

In summary, after controlling for risk and housing stock characteristics, subprime lending increased significantly as the portion of African-Americans and elderly people increased in a neighborhood. Pricing discrimination is widespread in the dual lending marketplace in America.

Metropolitan Areas Compared

Tables 12 through 14 sort MSAs by the effect of race and age factors on the level of subprime home purchase and refinance lending in a census tract. As Table 12 reveals, the percentage of African-Americans in a census tract imposed the strongest effect on subprime home purchase lending in Cleveland, Milwaukee, Detroit, and Atlanta. The African-American variable had the largest effect in Houston, Milwaukee, Detroit, and Cleveland for refinance lending. For example, in Houston a ten percentage point increase of African-Americans in a census tract, holding all other variables constant, would lead to an increase in the portion of subprime refinance loans of 4.058 percentage points. In contrast, in Baltimore a 10 percentage point increase in the portion of African-Ameri-

cans would lead to only a 1.107 percentage point increase in the portion of subprime refinance loans.

In Tables 12 through 14, the coefficients with one, two, or three asterisks are coefficients estimated at the 10%, 5%, and 1% level of statistical significance, respectively. In other words, these coefficients are valid in predicting the portion of subprime loans. In contrast, when the coefficients do not have asterisks, they cannot be used to predict the level of subprime loans.

The coefficient values for the African-American variables in this report are consistent with those in Calem, Gillen, and Wachter. The ordinary least squares regressions in the Calem, Gillen, and Wachter study estimated the African-American coefficient at about 0.2, which was approximately the median coefficient in our equations as reported in Table 12.

The portion of Hispanics in a census tract had the strongest impact in the Detroit and Houston MSAs for refinance lending, according to Table 13. In Detroit for example, a 10 percentage point increase in the Hispanic population would lead to 1.282 percentage point increase in the portion of subprime refinance lending.

The portion of people over 65 was a relatively strong variable in Detroit and Houston for home purchase lending and in St. Louis, Atlanta, and Houston for refinance lending. In particular, in the St. Louis MSA, a 10 percentage point increase of people over 65 would lead to a 3.065 percentage point increase in the portion of subprime refinance loans in a neighborhood.

In refinance and home purchase lending, the African-American portion of people in a census tract increased subprime lending regardless of the level of segregation in a MSA (see Table 12 which shows segregation levels as well as estimated coefficients for the African-American variable). For African-Americans, discrimination poses great difficulties across a wide swath of MSAs of different economic and demographic conditions. Regardless of the level of segregation, the African-American variable increased subprime refinance lending. No trends appeared regarding the level of segregation and the impact of the Hispanic variable on the amount of subprime lending.

Functional Form

Another dimension that should be discussed in this analysis is functional form: how it affects the results and what conclusions it informs. As stated above, NCRC used two forms when running the regressions: including and excluding race and age factors. The outputs are presented in the Tables 1 through 10. In most cases, the R square was lower when the race and age variables were excluded (this is observed clearly when comparing Columns 1 and 3 with the vh+h+m combined risk variable). This suggests that the equations explained a greater amount of the variation in the dependent variable when the race and age variables were included.

Calem, Gillen, and Wachter took a different iterative approach, but their findings were similar to our study. They ran some regressions with only demographic characteristics while we ran some regressions with only non-race variables. The end result of both approaches was that the R square was higher when the race variables were included.

Conclusion

After controlling for risk and housing market conditions, the race and age composition of the neighborhood had an independent and strong effect, increasing the amount of high cost subprime lending. The level of refinance subprime lending increased as the portion of African-Americans in a neighborhood increased in nine of the ten metropolitan areas. In the case of home purchase subprime lending, the African-American composition of a neighborhood boosted lending in six metropolitan areas. The impact of the age of borrowers was strong in refinance lending. In seven metropolitan areas, the portion of subprime refinance lending increased solely when the number of residents over 65 increased in a neighborhood. In America today, lenders engage in widespread price discrimination, making high cost loans based on the race and age of neighborhoods, not solely based on risk.

Appendix

HMDA Data: Its Strengths and Weaknesses

Enacted by Congress in 1975, the Home Mortgage Disclosure Act (HMDA) requires banks, savings and loan associations, credit unions, and other financial institutions to publicly report detailed data on their home lending activity. Under HMDA, lenders are required to disclose annually the number of loan applications by census tract, and by the income, race, and gender of the borrower. The law also requires institutions to indicate the number and dollar amount of the loans made.

Prior to 1990, lenders were required to report the census tract containing

the property for which the applicant succeeded or failed in obtaining a home loan. The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) required lenders to report the race, gender, and income of loan applicants and borrowers starting in 1990. Thus, HMDA data before 1990 reveals information only on the census tract location of the application or loan, whereas HMDA data after 1990 includes information on borrower characteristics. Also, starting in 1993, independent mortgage companies were required to report HMDA data.

HMDA requires lenders to report on a number of possible actions or "dispositions" on loan applications. Each year, the lender must report the number of loan applications it approved and denied. The lender must also indicate how many of its loan approvals were unaccepted (the bank approved the application but the applicant did not want the loan). Finally, the lender must specify how many applications were withdrawn (the applicant withdrew his application before the bank made a credit decision), and how many applications were incomplete (the application was not considered because the applicant did not provide all the necessary information).

Housing loans covered by HMDA include home purchase, home improvement, and refinance loans for single family dwellings (1 to 4 units) and loans for multi-family units. Lenders must disclose whether the loan was a conventional loan or a loan insured by a government agency such as the Federal Housing Administration (FHA), the Veterans Administration (VA), the Farm Service Agency (FSA), and the Rural Housing Service (RHS). Additional information reported includes the occupancy status of the property (owner occupied or non-owner occupied). The lender must also indicate if the loan was purchased on the secondary market and the

type of institution that bought the loan (for example, another bank or Fannie Mae or Freddie Mac).

Who is Covered by HMDA

A depository institution (bank, thrift, and credit union) must report HMDA data if it has a home office or branch in a metropolitan statistical area (MSA) and has assets above a threshold level that is adjusted upward every year by the rate of inflation. Before 1997, small depository institutions were exempt if they had assets less than $10 million. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended HMDA to adjust the exemption level to take into account annual inflation as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers. For the 1997 data, the asset level for exemption was increased from $10 million to $28 million (to take into account inflation occurring between 1975, the first year of HMDA data, through 1996). For 1998 and 1999 data collection, the Federal Reserve increased the asset level for exemption to $29 million. For the year 2000 and 2001, the Federal Reserve set the asset level for exemption to be $30 million and $31 million, respectively.

In addition, a depository institution is not required to report HMDA data if it did not make a home purchase loan on a 1-to-4 unit dwelling (or if it did not refinance a home purchase loan) during the previous calendar year.

Many non-depository institutions must also report HMDA data. An example of a non-depository institution is a mortgage company that does not accept deposits but raises funds for lending by borrowing from

investors. A non-depository institution must report HMDA data if it has more than $10 million in assets and it originated 100 or more home purchase loans (including refinances of home purchase loans) during the previous calendar year. A non-depository institution is exempt from HMDA reporting requirements if its home purchase loans (including refinances of home purchase loans) were less than 10 percent of all of its loan originations, measured in dollars, during the previous calendar year.

Gaps in HMDA Data

Small lenders and lenders with offices only in non-metropolitan areas (as noted above) are exempt from HMDA data reporting requirements. Data for rural areas is also incomplete, particularly information on the census tract location of loans. If banks and thrifts have assets under $250 million dollars (or are part of holding companies under $1 billion dollars), they do not have to report the census tract location for loans in MSAs (metropolitan statistical areas) in which they do not have any branch offices. They also do not have to report the census tract location for loans outside of MSAs.

Non-depository institutions do not have to report the census tract location of loans made in non-metropolitan areas. They have to report the census tract location of loans in those MSAs in which they received applications for, originated, or purchased five or more home purchase or home improvement loans during the preceding calendar year.

Another area of incompleteness concerns race and gender data of applications taken via the telephone. When applications are made in person, the loan officer is required to ask the applicant about his/her race. If the

applicant refuses, the loan officer is required to record race on the basis of visual observation or applicant surname. The loan officer is required to inform the applicant that federal law designed to combat discrimination requires this information. In contrast, when applications are received over the phone, the loan officer is not required to ask for the race and gender of the applicant (but this is about to change, see immediately below). When applications are received through the mail, the lending institution is required to ask for the race and gender of the applicant.

In the case of the electronic media, the official staff commentary of the Federal Reserve Board regarding the HMDA regulation states that lenders are required to ask for race and gender when applications are received over the Internet. When lenders are using electronic media with a video component, lenders are to use the same procedures as if the application is made in person.

Finally, a lender is not required to report the race, gender, and income data for loans that they purchase from another institution.

Improvements in HMDA Data

In the summer of 2002, the Federal Reserve Board made some significant changes to HMDA (the Federal Reserve Board has statutory responsibility to promulgate HMDA regulations). Lending institutions will be required to ask borrowers applying over the phone for their race and gender, starting in 2003.

In 2004, non-depository institutions making at least $25 million in home purchase loans will be required to report HMDA data. This will capture

more non-depository institutions as HMDA reporters than the thresholds described above. Lending institutions will be required to indicate in the HMDA data if the loans were for manufactured homes or traditional single family residences. The Federal Reserve Board will also require lenders to report price information if the APR on their loans exceeds the rate on Treasury securities by three percentage points for first-lien loans and five percentage points for second-lien loans.

Other changes to HMDA data beginning in 2004 include improving the definition of home improvement and refinance loans, requiring an indication if a loan is covered by the Home Ownership and Equity Protection Act, and requiring pre-approvals to be reported for home purchase loans. Finally, but importantly, lenders will be required to indicate the identity of their parent companies in the HMDA data.

Table 1: Detailed Regressions for Atlanta

Atlanta - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					Variable
Intercept	-0.0736	0.0001	-0.2301	-0.0743	Intercept
	-1.6899	0.0057	-6.9928	-3.4637	
%black [est. coeff.]	0.1393	0.1327			%black
[t-Score]	***8.4146***	***7.4253***			
%hisp [est. coeff.]	-0.2080	-0.2475			%hisp
[t-Score]	-1.3761	-1.6392			
%65age [est. coeff.]	0.0845	0.0404			%65age
[t-Score]	1.2000	0.6217			
medage [est. coeff.]	-0.0060	-0.0052	0.0114	0.0104	medage
[t-Score]	-0.9145	-0.7775	*1.7122*	1.6101	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	**2.0566**	1.6146	***3.8901***	***3.1293***	
HT [est. coeff.]	-0.0007	0.0000	-0.0042	-0.0034	HT
[t-Score]	-0.3130	-0.0374	**-1.9974**	*-1.6600*	
capitaliz [est. coeff.]	2.2945	2.3405	0.3412	0.0582	capitaliz
[t-Score]	1.3955	1.4269	0.1905	0.0336	
%vhigh [est. coeff.]		0.1635		0.4289	%vhigh
[t-Score]		***2.8298***		***8.9836***	
% NC [est. coeff.]	0.0756	-0.0036	0.5576	0.2826	%NC
[t-Score]	0.8172	-0.0403	***7.3417***	***3.4278***	
vh+h+m [est. coeff.]	0.1621		0.3740		vh+h+m
[t-Score]	***2.8550***		***7.7943***		
Adj R-square	0.4566	0.4564	0.3429	0.3684	**Adj R-square**

Atlanta - Refinance

Variable					Variable
Intercept	-0.2316	-0.0823	-0.4070	-0.1572	Intercept
	-4.9917	-3.1144	-10.8020	-6.5746	
%black [est. coeff.]	0.1886	0.1682			%black
[t-Score]	***11.1936***	***9.2579***			
%hisp [est. coeff.]	-0.2456	-0.3350			%hisp
[t-Score]	-1.5388	**-2.1166**			
%65age [est. coeff.]	0.2701	0.1899			%65age
[t-Score]	***3.6791***	***2.8195***			
medage [est. coeff.]	0.0016	0.0043	0.0325	0.0310	medage
[t-Score]	0.2257	0.6160	***4.2526***	***4.3506***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***2.7783***	**1.9990**	***4.0840***	***3.1652***	
HT [est. coeff.]	-0.0021	-0.0008	-0.0065	-0.0052	HT
[t-Score]	-0.8715	-0.3277	***-2.7204***	**-2.3121**	
capitaliz [est. coeff.]	7.9826	7.7769	5.7983	4.8837	capitaliz
[t-Score]	***4.7224***	***4.6556***	***2.9185***	***2.6230***	
%vhigh [est. coeff.]		0.3827		0.7148	%vhigh
[t-Score]		***6.2345***		***13.6511***	
%NC [est. coeff.]	0.1760	0.0061	0.8036	0.3462	%NC
[t-Score]	*1.8166*	0.0654	***9.1324***	***3.7494***	
vh+h+m [est. coeff.]	0.3458		0.6046		vh+h+m
[t-Score]	***5.6966***		***11.0804***		
Adj R-square	0.6903	0.6944	0.5654	0.6091	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 2: Detailed Regressions for Baltimore

Baltimore - Home Purchase

Variable	Column 1	Column 2	Column 3	Column 4	Variable
Intercept	-0.0274	0.0012	-0.0174	0.0128	Intercept
	-0.9384	0.0629	-0.9437	0.8683	
%black [est. coeff.]	0.0063	-0.0096			%black
[t-Score]	0.5582	-0.7825			
%hisp [est. coeff.]	-0.0890	-0.1080			%hisp
[t-Score]	-0.5333	-0.6547			
%65age [est. coeff.]	0.0367	0.0270			%65age
[t-Score]	0.9263	0.7600			
medage [est. coeff.]	0.0014	0.0017	0.0027	0.0026	medage
[t-Score]	0.3706	0.4567	0.7710	0.7620	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.6878	1.1145	0.4214	0.7548	
HT [est. coeff.]	-0.0209	-0.0133	-0.0267	-0.0164	HT
[t-Score]	-1.0024	-0.6474	-1.3083	-0.8145	
capitaliz [est. coeff.]	-1.5117	-2.3430	-1.4297	-2.1868	capitaliz
[t-Score]	-1.2807	*-1.9550*	-1.2171	*-1.8440*	
%vhigh [est. coeff.]		0.1912		0.1605	%vhigh
[t-Score]		***4.1024***		***5.0770***	
%NC [est. coeff.]	0.1625	0.1064	0.1432	0.0865	%NC
[t-Score]	**2.4925**	*1.6110*	**2.3639**	1.3829	
vh+h+m [est. coeff.]	0.1096		*0.1076*		vh+h+m
[t-Score]	***2.7570***		***3.9710***		
Adj R-square	0.0843	0.1028	0.0864	0.1059	**Adj R-square**

Baltimore - Refinance

Variable					Variable
Intercept	-0.1032	-0.0535	-0.1591	-0.0692	Intercept
	-2.7780	-2.0886	-6.0809	-3.2914	
%black [est. coeff.]	0.1107	0.1016			%black
[t-Score]	***8.0671***	***6.7403***			
%hisp [est. coeff.]	-0.4806	-0.5125			%hisp
[t-Score]	**-2.2312**	**-2.3859**			
%65age [est. coeff.]	0.1307	0.1012			%65age
[t-Score]	**2.5661**	**2.2017**			
medage [est. coeff.]	0.0041	0.0044	0.0104	0.0096	medage
[t-Score]	0.8486	0.9049	**2.0732**	**1.9929**	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.2127	0.1780	0.3565	0.8598	
HT [est. coeff.]	-0.1173	-0.1081	-0.1724	-0.1429	HT
[t-Score]	***-4.3461***	***-4.0315***	***-5.9525***	***-5.1085***	
capitaliz [est. coeff.]	11.4350	11.0128	12.1084	10.2778	capitaliz
[t-Score]	***7.4773***	***7.0691***	***7.2380***	***6.2013***	
%vhigh [est. coeff.]		0.1915		0.4338	%vhigh
[t-Score]		***3.2109***		***9.8300***	
%NC [est. coeff.]	0.3391	0.2854	0.3476	0.2013	%NC
[t-Score]	***3.9410***	***3.2582***	***3.9729***	**2.2663**	
vh+h+m [est. coeff.]	0.1471		0.3089		vh+h+m
[t-Score]	***2.9374***		***8.0034***		
Adj R-square	0.6306	0.6320	0.5539	0.5801	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 3: Detailed Regressions for Cleveland

Cleveland - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0968	-0.0667	-0.2787	-0.1445	Intercept
	-2.4616	-2.6279	-9.6417	-6.9277	
%black [est. coeff.]	0.2400	0.2159			%black
[t-Score]	***15.6258***	***11.9307***			
%hisp [est. coeff.]	-0.0317	-0.0693			%hisp
[t-Score]	-0.5279	-1.1269			
%65age [est. coeff.]	0.0698	0.0496			%65age
[t-Score]	1.2876	1.0664			
medage [est. coeff.]	0.0114	0.0104	0.0029	0.0008	medage
[t-Score]	**2.1543**	**1.9885**	0.4430	0.1363	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.0055	0.5456	**2.3867**	***4.2976***	
HT [est. coeff.]	-0.0425	-0.0405	-0.2003	-0.1330	HT
[t-Score]	-0.8212	-0.7884	***-3.1160***	***-2.2735***	
capitaliz [est. coeff.]	8.3768	7.5255	10.5030	6.1981	capitaliz
[t-Score]	***5.2034***	***4.5995***	***5.1443***	***3.2482***	
%vhigh [est. coeff.]		0.2395		0.8201	%vhigh
[t-Score]		***3.3621***		***15.3546***	
%NC [est. coeff.]	0.1226	0.0691	0.2533	0.0019	%NC
[t-Score]	**2.2792**	1.2988	***4.0533***	0.0307	
vh+h+m [est. coeff.]	0.1274		0.5215		vh+h+m
[t-Score]	**2.2510**		***10.6801***		
Adj R-square	0.6865	0.6904	0.4906	0.5747	**Adj R-square**

Cleveland – Refinance

Variable					**Variable**
Intercept	-0.2596	-0.1557	-0.3936	-0.1729	Intercept
	-6.1378	-5.8013	-13.4316	-8.6214	
%black [est. coeff.]	0.1988	0.1238			%black
[t-Score]	***12.4492***	***6.7255***			
%hisp [est. coeff.]	0.0693	-0.0251			%hisp
[t-Score]	1.1136	-0.4123			
%65age [est. coeff.]	0.1635	0.1104			%65age
[t-Score]	***2.8461***	**2.2404**			
medage [est. coeff.]	0.0134	0.0094	0.0028	0.0019	medage
[t-Score]	**2.1879**	1.6132	0.3966	0.3124	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	-0.5386	1.0357	0.8153	***2.8402***	
HT [est. coeff.]	0.0142	0.0298	-0.2029	-0.0665	HT
[t-Score]	0.2246	0.4945	***-2.8433***	-1.0777	
capitaliz [est. coeff.]	16.4428	14.1417	16.9059	12.1840	capitaliz
[t-Score]	***9.4880***	***8.3802***	***8.4575***	***6.9456***	
%vhigh [est. coeff.]		0.7923		1.1672	%vhigh
[t-Score]		***10.3537***		***24.0454***	
%NC [est. coeff.]	0.3718	0.1896	0.4998	0.1288	%NC
[t-Score]	***5.9831***	***3.1951***	***7.5462***	**2.1248**	
vh+h+m [est. coeff.]	0.4403			0.8241	vh+h+m
[t-Score]	***7.0236***			***16.8755***	
Adj R-square	0.8108	0.8268	0.7400	0.8060	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 4: Detailed Regressions for Detroit

Detroit - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.1612	-0.0673	-0.2883	-0.1217	Intercept
	-6.5514	-4.5959	-15.3291	-10.5391	
%black [est. coeff.]	0.1661	0.1414			%black
[t-Score]	***17.3528***	***12.6615***			
%hisp [est. coeff.]	0.0645	0.0671			%hisp
[t-Score]	0.8549	0.8940			
%65age [est. coeff.]	0.1606	0.1108			%65age
[t-Score]	***4.5974***	***3.5032***			
medage [est. coeff.]	-0.0009	-0.0006	0.0073	0.0064	medage
[t-Score]	-0.2483	-0.1527	*1.6466*	1.5942	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***7.0185***	***7.2346***	***9.5542***	***11.2168***	
HT [est. coeff.]	-0.0487	-0.0422	-0.0668	-0.0487	HT
[t-Score]	***-2.7491***	***-2.3909***	***-3.1544***	**-2.5180**	
capitaliz [est. coeff.]	0.9817	0.2664	2.6210	-0.0667	capitaliz
[t-Score]	1.5908	0.4177	***3.6241***	-0.0964	
%vhigh [est. coeff.]		0.2817		0.5624	%vhigh
[t-Score]		***7.9450***		***21.2638***	
%NC [est. coeff.]	0.2134	0.0892	0.3806	0.0654	%NC
[t-Score]	***4.3575***	*1.7369*	***7.1284***	1.2392	
vh+h+m [est. coeff.]	0.2435		0.4483		vh+h+m
[t-Score]	***7.3623***		***15.2271***		
Adj R-square	0.6267	0.6302	0.4622	0.5494	**Adj R-square**

Detroit - Refinance

Variable					**Variable**
Intercept	0.0163	0.0239	0.0160	0.0166	Intercept
	1.2207	2.3102	0.7742	1.0967	
%black [est. coeff.]	0.2577	0.2578			%black
[t-Score]	***40.0263***	***40.0004***			
%hisp [est. coeff.]	0.1282	0.1295			%hisp
[t-Score]	***2.6175***	***2.6440***			
%65age [est. coeff.]	-0.0634	-0.0633			%65age
[t-Score]	**-2.2064**	**-2.2031**			
medage [est. coeff.]	0.0059	0.0059	0.0071	0.0070	medage
[t-Score]	1.6232	1.6277	1.2371	1.2299	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***-5.1794***	***-5.1494***	***-5.6100***	***-5.5512***	
HT [est. coeff.]	-0.0940	-0.0940	-0.1672	-0.1674	HT
[t-Score]	***-4.2685***	***-4.2686***	***-4.6023***	***-4.6095***	
capitaliz [est. coeff.]	12.4840	12.4769	21.6557	21.6289	capitaliz
[t-Score]	***25.9571***	***25.9340***	***32.1928***	***32.1477***	
%vhigh [est. coeff.]		0.0088		-0.0266	%vhigh
[t-Score]		0.4675		-0.8586	
%NC [est. coeff.]	-0.0270	-0.0244	-0.0912	-0.0518	%NC
[t-Score]	-0.9466	-0.6699	*-1.9387*	-0.8615	
vh+h+m [est. coeff.]	0.0190		-0.0006		vh+h+m
[t-Score]	0.9414		-0.0181		
Adj R-square	0.8993	0.8992	0.7224	0.7226	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 5: Detailed Regressions for Houston

Houston - Home Purchase

Variable	Column 1	Column 2	Column 3	Column 4	**Variable**
Intercept	-0.0716	-0.0121	-0.0638	0.0024	Intercept
	-2.3607	-0.6369	-2.4380	0.1439	
%black [est. coeff.]	0.0492	0.0061			%black
[t-Score]	***3.5117***	0.3776			
%hisp [est. coeff.]	-0.0260	-0.0244			%hisp
[t-Score]	-1.4890	-1.4337			
%65age [est. coeff.]	0.1597	0.1507			%65age
[t-Score]	***2.5969***	***2.5793***			
medage [est. coeff.]	-0.0021	-0.0009	0.0026	0.0037	medage
[t-Score]	-0.3409	-0.1577	0.5345	0.8384	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.9668	*1.6872*	1.0104	*1.9404*	
HT [est. coeff.]	-0.0030	0.0002	-0.0025	-0.0003	HT
[t-Score]	-1.0546	0.0876	-0.8813	-0.0933	
capitaliz [est. coeff.]	-0.3612	-1.4909	-1.0640	-2.2156	capitaliz
[t-Score]	-0.3971	-1.6291	-1.1510	**-2.5192**	
%vhigh [est. coeff.]		0.3416		0.3347	%vhigh
[t-Score]		***7.2297***		***9.3429***	
%NC [est. coeff.]	0.0590	-0.0969	0.0596	-0.1120	%NC
[t-Score]	1.0204	*-1.6705*	1.0468	**-1.9726**	
vh+h+m [est. coeff.]	0.2145		0.2307		vh+h+m
[t-Score]	***5.3134***		***6.4863***		
Adj R-square	0.1762	0.2121	0.1302	0.1969	**Adj R-square**

Houston - Refinance

Variable					**Variable**
Intercept	-0.2230	-0.1553	-0.4695	-0.2285	Intercept
	-4.2211	-4.7643	-8.2199	-7.2035	
%black [est. coeff.]	0.4058	0.3194			%black
[t-Score]	***17.8827***	***11.8561***			
%hisp [est. coeff.]	0.0694	0.0660			%hisp
[t-Score]	**2.2102**	**2.1770**			
%65age [est. coeff.]	0.2483	0.2632			%65age
[t-Score]	**2.2765**	***2.5762***			
medage [est. coeff.]	0.0397	0.0446	0.0859	0.0888	medage
[t-Score]	***3.7532***	***4.3637***	***8.0243***	***10.2813***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.2985	1.3561	0.9242	***2.9685***	
HT [est. coeff.]	-0.0296	-0.0227	-0.0206	-0.0101	HT
[t-Score]	***-6.1039***	***-4.6654***	***-3.2921***	*-1.8924*	
capitaliz [est. coeff.]	14.4833	11.5724	10.9087	4.9465	capitaliz
[t-Score]	***9.0106***	***7.1455***	***5.1527***	**2.8008**	
%vhigh [est. coeff.]		0.6078		1.2788	%vhigh
[t-Score]		***6.9964***		***18.2973***	
%NC [est. coeff.]	0.2893	-0.0187	0.5737	-0.2016	%NC
[t-Score]	***2.6597***	-0.1652	***4.0848***	-1.5846	
vh+h+m [est. coeff.]	0.3045		0.8178		vh+h+m
[t-Score]	***4.1601***		***10.1633***		
Adj R-square	0.7364	0.7529	0.5333	0.6690	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 6: Detailed Regressions for Los Angeles

Los Angeles - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0148	0.0871	-0.0453	0.0472	Intercept
	-0.5055	4.7543	-2.0613	3.4345	
%black [est. coeff.]	0.0434	0.0278			%black
[t-Score]	***3.7431***	**2.2361**			
%hisp [est. coeff.]	-0.0738	-0.0662			%hisp
[t-Score]	***-6.5858***	***-6.0490***			
%65age [est. coeff.]	-0.0702	-0.1048			%65age
[t-Score]	*-1.6689*	**-2.5966**			
medage [est. coeff.]	0.0094	0.0088	0.0066	0.0050	medage
[t-Score]	**2.1647**	**2.0267**	1.5305	1.1809	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.4378	0.8086	*1.7249*	***3.0392***	
HT [est. coeff.]	-0.0514	-0.0332	-0.0211	-0.0031	HT
[t-Score]	*-1.9595*	-1.2885	-0.8087	-0.1218	
capitaliz [est. coeff.]	-7.2678	-8.6568	-7.7193	-11.1339	capitaliz
[t-Score]	***-3.8854***	***-4.5039***	***-4.0284***	***-5.8148***	
%vhigh [est. coeff.]		0.3435		0.4428	%vhigh
[t-Score]		***7.7136***		***11.8946***	
%NC [est. coeff.]	0.1144	-0.0043	0.0208	-0.1125	%NC
[t-Score]	**2.4322**	-0.0945	0.5577	***-2.9010***	
vh+h+m [est. coeff.]	0.2952		0.3193		vh+h+m
[t-Score]	***7.3164***		***9.0717***		
Adj R-square	0.1407	0.1441	0.0644	0.0997	**Adj R-square**

Los Angeles - Refinance

Variable					**Variable**
Intercept [est. coeff.]	-0.0906	-0.0129	-0.1650	-0.0638	Intercept
	-4.3821	-1.0019	-9.8654	-6.2372	
%black [est. coeff.]	0.1378	0.1286			%black
[t-Score]	***16.9109***	***14.6106***			
%hisp [est. coeff.]	0.0280	0.0342			%hisp
[t-Score]	***3.5810***	***4.4814***			
%65age [est. coeff.]	0.0756	0.0452			%65age
[t-Score]	**2.5679**	1.6024			
medage [est. coeff.]	0.0091	0.0087	0.0194	0.0177	medage
[t-Score]	***2.9504***	***2.8080***	***5.8533***	***5.5704***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***3.0705***	***3.1206***	***3.3433***	***5.2530***	
HT [est. coeff.]	-0.0318	-0.0192	-0.0829	-0.0660	HT
[t-Score]	*-1.7193*	-1.0509	***-4.2070***	***-3.5052***	
capitaliz [est. coeff.]	5.5637	4.8410	7.4860	3.8030	capitaliz
[t-Score]	***4.2604***	***3.6001***	***5.1977***	***2.7021***	
%vhigh [est. coeff.]		0.2280		0.4768	%vhigh
[t-Score]		***7.3062***		***17.5866***	
%NC [est. coeff.]	0.1631	0.0799	0.2772	0.1393	%NC
[t-Score]	***4.9454***	**2.5321**	***9.9885***	***4.9591***	
vh+h+m [est. coeff.]	0.2113		0.3472		vh+h+m
[t-Score]	***7.4171***		***13.0532***		
Adj R-square	0.5252	0.5247	0.4009	0.4467	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 7: Detailed Regressions for Milwaukee

Milwaukee - Home Purchase

Variable	Column 1	Column 2	Column 3	Column 4	**Variable**
Intercept [est. coeff.]	-0.0561	0.0130	-0.1595	-0.0106	Intercept
	-1.3438	0.3896	-5.7474	-0.4008	
%black [est. coeff.]	0.1844	0.1457			%black
[t-Score]	***6.8455***	***4.3336***			
%hisp [est. coeff.]	-0.0610	-0.0752			%hisp
[t-Score]	-0.6171	-0.7587			
%65age [est. coeff.]	0.0231	-0.0225			%65age
[t-Score]	0.4227	-0.4502			
medage [est. coeff.]	-0.0010	-0.0006	-0.0124	-0.0095	medage
[t-Score]	-0.1977	-0.1161	***-2.4492***	**-2.0155**	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	-0.3238	-0.6619	0.9549	0.5907	
HT [est. coeff.]	-0.1624	-0.1526	-0.1719	-0.1504	HT
[t-Score]	***-3.8946***	***-3.6747***	***-3.8059***	***-3.6134***	
capitaliz [est. coeff.]	3.8248	2.5950	7.2203	1.5137	capitaliz
[t-Score]	*1.6469*	1.0752	***2.9384***	0.6136	
%vhigh [est. coeff.]		0.2419		0.5094	%vhigh
[t-Score]		**3.3803**		***10.5301***	
%NC [est. coeff.]	0.0356	-0.0717	0.0597	-0.2022	% NC
[t-Score]	0.3727	-0.7106	0.6883	-2.2449	
vh+h+m [est. coeff.]	0.1751		0.3760		vh+h+m
[t-Score]	***3.1259***		***7.8538***		
Adj R-square	0.5929	0.5953	0.4931	0.5567	**Adj R-square**

Milwaukee - Refinance

Variable					**Variable**
Intercept [est. coeff.]	-0.1289	-0.0553	-0.3075	-0.0990	Intercept
	-3.3313	-1.9004	-9.9169	-4.1451	
%black [est. coeff.]	0.2913	0.2290			%black
[t-Score]	***13.4897***	***8.8845***			
%hisp [est. coeff.]	0.0253	-0.0129			%hisp
[t-Score]	0.3411	-0.1760			
%65age [est. coeff.]	0.0682	0.0207			%65age
[t-Score]	1.2791	0.4296			
medage [est. coeff.]	-0.0010	-0.0014	-0.0226	-0.0161	medage
[t-Score]	-0.2040	-0.2998	***-3.7912***	***-3.2240***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.9831	1.0871	**2.4469**	***3.0354***	
HT [est. coeff.]	-0.2229	-0.2103	-0.2733	-0.2261	HT
[t-Score]	***-5.4905***	***-5.3254***	***-5.1182***	***-5.0763***	
capitaliz [est. coeff.]	7.0170	5.3346	13.0116	5.1581	capitaliz
[t-Score]	***3.6779***	***2.7993***	***5.4563***	**2.4298**	
%vhigh [est. coeff.]		0.3505		0.7782	%vhigh
[t-Score]		***6.0860***		***18.1084***	
%NC [est. coeff.]	0.2398	0.1268	0.3423	0.0121	%NC
[t-Score]	***2.8523***	1.5293	***4.1184***	0.1611	
vh+h+m [est. coeff.]	0.2216		0.5925		vh+h+m
[t-Score]	***4.4829***		***11.8902***		
Adj R-square	0.8391	0.8470	0.7107	0.7952	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 8: Detailed Regressions for New York

New York - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					Variable
Intercept	-0.0831	-0.0156	-0.0693	-0.0026	Intercept
	-3.7671	-1.1341	-5.2760	-0.2874	
%black [est. coeff.]	-0.0028	-0.0333			%black
[t-Score]	-0.2905	***-2.9956***			
%hisp [est. coeff.]	-0.0176	-0.0175			%hisp
[t-Score]	-1.1753	-1.1991			
%65age [est. coeff.]	0.0245	-0.0133			%65age
[t-Score]	0.8318	-0.4858			
medage [est. coeff.]	0.0063	-0.0049	-0.0066	-0.0052	medage
[t-Score]	**-2.2128**	*-1.7481*	**-2.3241**	*-1.8580*	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.8508	1.2882	0.8606	0.9210	
HT [est. coeff.]	-0.0671	-0.0652	-0.0698	-0.0650	HT
[t-Score]	***-5.1135***	***-5.0214***	***-5.3603***	***-5.0273***	
capitaliz [est. coeff.]	4.5458	4.0967	4.5306	4.1659	capitaliz
[t-Score]	***4.6141***	***4.1908***	***4.6271***	***4.2846***	
%vhigh [est. coeff.]		0.3385		0.2506	%vhigh
[t-Score]		***8.6606***		***10.5744***	
%NC [est. coeff.]	0.1373	0.0628	0.1113	0.0342	%NC
[t-Score]	***3.1419***	1.4733	***3.0438***	0.8812	
vh+h+m [est. coeff.]	0.2211		0.2046		vh+h+m
[t-Score]	***7.0687***		***9.6398***		
Adj R-square	0.2235	0.2412	0.2237	0.2366	**Adj R-square**

New York - Refinance

Variable					Variable
Intercept	-0.3449	-0.0956	-0.3494	-0.1038	Intercept
	-15.0857	-5.5738	-16.6523	-7.0802	
%black [est. coeff.]	-0.0045	-0.0048			%black
[t-Score]	-0.5259	-0.5912			
%hisp [est. coeff.]	-0.0181	-0.0238			%hisp
[t-Score]	-1.3867	*-1.9461*			
%65age [est. coeff.]	-0.0054	-0.0127			%65age
[t-Score]	-0.1350	-0.3377			
medage [est. coeff.]	0.0244	0.0173	0.0246	0.0175	medage
[t-Score]	***4.8576***	***3.6681***	***5.0704***	***3.8485***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	0.9236	1.1906	0.9846	1.2698	
HT [est. coeff.]	-0.2578	-0.2235	-0.2623	-0.2303	HT
[t-Score]	***-5.0285***	***-4.6395***	***-5.1396***	***-4.7978***	
capitaliz [est. coeff.]	8.2697	5.9878	8.3394	6.0702	capitaliz
[t-Score]	***3.7790***	***2.9259***	***3.8197***	***2.9704***	
%vhigh [est. coeff.]		0.8740		0.8669	%vhigh
[t-Score]		***25.6367***		***25.5495***	
%NC [est. coeff.]	0.6245	0.3339	0.6313	0.3443	%NC
[t-Score]	***9.7477***	***5.2304***	***9.8874***	***5.4100***	
vh+h+m [est. coeff.]	0.7021		0.6974		vh+h+m
[t-Score]	***21.3501***		***21.3121***		
Adj R-square	0.5878	0.6363	0.5881	0.6358	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 9: Detailed Regressions for St. Louis

St. Louis - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.3851	-0.2098	-0.3840	-0.2093	Intercept
	-10.3472	-8.2588	-10.7522	-8.4073	
%black [est. coeff.]	0.0060	0.0068			%black
[t-Score]	0.5060	0.6852			
%hisp [est. coeff.]	0.2666	0.3189			%hisp
[t-Score]	1.2764	*1.6922*			
%65age [est. coeff.]	-0.0294	-0.0279			%65age
[t-Score]	-0.4692	-0.4977			
medage [est. coeff.]	0.0287	0.0140	0.0290	0.0148	medage
[t-Score]	***3.2903***	*1.7411*	***3.9000***	**2.1538**	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***5.2746***	***6.0803***	***5.2586***	***6.0563***	
HT [est. coeff.]	-0.2985	-0.2102	-0.3006	-0.2131	HT
[t-Score]	***-3.9183***	***-3.1781***	***-3.9678***	***-3.2254***	
capitaliz [est. coeff.]	10.5586	4.7064	10.6740	4.9026	capitaliz
[t-Score]	***4.6207***	**2.1910**	***4.7203***	**2.2988**	
%vhigh [est. coeff.]		0.8341		0.8276	%vhigh
[t-Score]		***12.1652***		***12.2001***	
%NC [est. coeff.]	0.5673	0.1533	0.5672	0.1557	%NC
[t-Score]	***6.4062***	*1.7063*	***6.4251***	*1.7330*	
vh+h+m	0.4893		0.4862		vh+h+m
[t-Score]	***7.3599***		***7.4763***		
Adj R-square	0.5441	0.6289	0.5453	0.6284	**Adj R-square**

St. Louis - Refinance

Variable					**Variable**
Intercept	-0.4462	-0.2706	-0.5173	-0.2867	Intercept
	-8.9409	-8.9943	-12.3150	-10.8358	
%black [est. coeff.]	0.1822	0.1405			%black
[t-Score]	***10.4092***	***8.0440***			
%hisp [est. coeff.]	0.2816	0.2517			%hisp
[t-Score]	0.7563	0.7189			
%65age [est. coeff.]	0.3065	0.2401			%65age
[t-Score]	***4.2338***	***3.7708***			
medage [est. coeff.]	0.0189	0.0192	0.0347	0.0322	medage
[t-Score]	***2.8394***	***3.0790***	***4.9275***	***5.2674***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***4.7326***	***5.0831***	***5.3023***	***5.8190***	
HT [est. coeff.]	-0.1380	-0.1004	-0.3125	-0.2252	HT
[t-Score]	*-1.8453*	-1.4468	***-3.7234***	***-3.0865***	
capitaliz [est. coeff.]	15.1680	12.6709	15.6756	11.5736	capitaliz
[t-Score]	***8.7029***	***7.5884***	***7.7473***	***6.3298***	
%vhigh [est. coeff.]		0.7636		1.0054	%vhigh
[t-Score]		***10.3399***		***14.6164***	
%NC [est. coeff.]	0.5985	0.2600	0.9368	0.3687	%NC
[t-Score]	***6.8804***	***2.9608***	***10.9743***	***4.0613***	
vh+h+m [est. coeff.]	0.5096		0.6599		vh+h+m
[t-Score]	***7.0111***		***9.2071***		
Adj R-square	0.8156	0.8368	0.7509	0.8032	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 10: Detailed Regressions for Washington, D.C.

Washington - Home Purchase

	Column 1	Column 2	Column 3	Column 4	
Variable					**Variable**
Intercept	-0.0921	-0.0403	-0.0839	-0.0303	Intercept
	-4.7182	-3.9111	-6.9137	-3.8307	
%black [est. coeff.]	0.0007	-0.0162			%black
[t-Score]	0.0815	*-1.9010*			
%hisp [est. coeff.]	-0.0230	-0.0117			%hisp
[t-Score]	-1.0384	-0.5382			
%65age [est. coeff.]	0.0415	0.0265			%65age
[t-Score]	1.6110	1.1546			
medage [est. coeff.]	0.0035	0.0043	0.0050	0.0034	medage
[t-Score]	1.4144	*1.7684*	**2.3703**	*1.6626*	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	***6.7120***	***7.7899***	***7.4649***	***7.9575***	
HT [est. coeff.]	-0.0152	-0.0083	-0.0159	-0.0082	HT
[t-Score]	**-2.5370**	-1.4396	***-2.6972***	-1.4197	
capitaliz [est. coeff.]	2.7519	1.2741	2.8480	1.7619	capitaliz
[t-Score]	***3.2323***	1.4574	***3.4670***	**2.1306**	
%vhigh [est. coeff.]		0.2455		0.1992	%vhigh
[t-Score]		***8.2219***		***11.1844***	
%NC [est. coeff.]	0.1122	0.0371	0.1043	0.0239	%NC
[t-Score]	***4.0712***	1.5746	***4.7132***	1.0587	
vh+h+m [est. coeff.]	0.1611		0.1530		vh+h+m
[t-Score]	***5.8323***		***9.3834***		
Adj R-square	0.1876	0.2180	0.1853	0.2168	**Adj R-square**

Washington - Refinance

Variable					**Variable**
Intercept	-0.0885	-0.0067	-0.1401	-0.0285	Intercept
	-4.4291	-0.6134	-10.6061	-3.3379	
%black [est. coeff.]	0.0557	0.0522			%black
[t-Score]	***6.6773***	***6.0619***			
%hisp [est. coeff.]	-0.1044	-0.0916			%hisp
[t-Score]	***-4.7428***	***-4.1683***			
%65age [est. coeff.]	0.1105	0.0694			%65age
[t-Score]	***3.9719***	***2.7602***			
medage [est. coeff.]	0.0015	0.0014	0.0126	0.0094	medage
[t-Score]	0.6225	0.5641	***5.4239***	***4.2054***	
medhhinc [est. coeff.]	0.0000	0.0000	0.0000	0.0000	medhhinc
[t-Score]	1.5437	0.4820	***3.1343***	***2.5557***	
HT [est. coeff.]	-0.0326	-0.0234	-0.0469	-0.0296	HT
[t-Score]	***-4.9534***	***-3.6294***	***-6.7679***	***-4.4176***	
capitaliz [est. coeff.]	5.3927	4.4650	4.8013	2.8950	capitaliz
[t-Score]	***6.2500***	***4.8876***	***5.3119***	***3.2051***	
%vhigh [est. coeff.]		0.2274		0.3725	%vhigh
[t-Score]		***7.3702***		***19.4870***	
%NC [est. coeff.]	0.0900	-0.0049	0.1492	0.0014	%NC
[t-Score]	***3.1698***	-0.2003	***6.0717***	0.0573	
vh+h+m [est. coeff.]	0.2006		0.3043		vh+h+m
[t-Score]	***7.2331***		***17.2681***		
Adj R-square	0.5908	0.5917	0.5151	0.5473	**Adj R-square**

Italic - 10% level of significance
Bolded - 5% level of significance
Bolded and Italicized - 1% level of significance

Table 11: Summary of Regression Results

Home Purchase Lending

Variable	Atl.	Balt.	Cleve.	Det.	Hous.	LA	Milw.	NYC	St. L.	D.C.
%black	+++		+++	+++	+++	+++	+++			
%hisp						- - -				
%65age				+++	+++	-				
medage			++			++		- -	+++	
medhhinc	++			+++					+++	+++
HT				- - -		-	- - -	- - -	- - -	- -
capitaliz			+++			- - -	+	+++	+++	+++
NC		++	++	+++		++		+++	+++	+++
vh+h+m	+++	+++	++	+++	+++	+++	+++	+++	+++	+++
Adj R-square	0.4566	0.0843	0.6865	0.6267	0.1762	0.1407	0.5929	0.2235	0.5441	0.1876

Refinance Lending

Variable	Atl.	Balt.	Cleve.	Det.	Hous.	LA	Milw.	NYC	St. L.	D.C.
%black	+++	+++	+++	+++	+++	+++	+++		+++	+++
%hisp		- -		+++	++	+++				- - -
%65age	+++	++	+++	- -	++	++			+++	+++
medage			++		+++	+++		+++	+++	
medhhinc	+++			- - -		+++			+++	
HT		- - -		- - -	- - -	-	- - -	- - -	-	- - -
capitaliz	+++	+++	+++	+++	+++	+++	+++	+++	+++	+++
NC	+	+++	+++		+++	+++	+++	+++	+++	+++
vh+h+m	+++	+++	+++		+++	+++	+++	+++	+++	+++
Adj R-square	0.6903	0.6306	0.8108	0.8993	0.7364	0.5252	0.8391	0.5878	0.8156	0.5908

\+ positive relationship
\- negative relationship
\+ or - 10% significance level
++ or - - 5% significance level
+++ or - - - 1% significance level

Table 12: Impact of Number of African-Americans in a Neighborhood

Percent African-Americans in a census tract

Home Purchase

	Estimated coefficient	Level of Significance	White/African-American Segregation Index
Cleveland	0.2400	***	79.7
Milwaukee	0.1844	***	84.4
Detroit	0.1661	***	86.7
Atlanta	0.1393	***	68.8
Houston	0.0492	***	71.8
Los Angeles	0.0434	***	70.5
Baltimore	0.0063		71.8
St. Louis	0.0060		78.0
Washington	0.0007		66.2
New York	-0.0028		84.3

Refinance

	Estimated coefficient	Level of Significance	White/African-American Segregation Index
Houston	0.4058	***	71.8
Milwaukee	0.2913	***	84.4
Detroit	0.2577	***	86.7
Cleveland	0.1988	***	79.7
Atlanta	0.1866	***	68.8
St. Louis	0.1822	***	78.0
Los Angeles	0.1378	***	70.5
Baltimore	0.1107	***	71.8
Washington	0.0557	***	66.2
New York	-0.0045		84.3

* - 10% level of significance
** - 5% level of significance
*** - 1% level of significance

The dissimilarity index varies between 0 and 100, and measures the percentage of one group that would have to move across neighborhoods to be distributed the same way as the second group. A dissimilarity index of 0 indicates conditions of total integration. A dissimilarity index of 100 indicates conditions of total segregation. For more information see www.CensusScope.org of the Social Science Data Analysis Network at the University of Michigan.

Table 13: Impact of Number of Hispanics in a Neighborhood

Percent Hispanics in a census tract

Home Purchase

	Estimated coefficient	Level of Significance	White/Hispanic Segregation Index
St. Louis	0.2666		36.7
Detroit	0.0645		48.3
New York	-0.0176		69.3
Washington	-0.0230		52.5
Houston	-0.0260		59.2
Cleveland	-0.0317		59.0
Milwaukee	-0.0610		60.6
Los Angeles	-0.0738	***	64.4
Baltimore	-0.0890		40.3
Atlanta	-0.2080		56.8

Refinance

	Estimated coefficient	Level of Significance	White/Hispanic Segregation Index
St. Louis	0.2816		36.7
Detroit	0.1282	***	48.3
Houston	0.0694	**	59.2
Cleveland	0.0693		59.0
Los Angeles	0.0280	***	64.4
Milwaukee	0.0253		60.6
New York	-0.0181		69.3
Washington	-0.1044	***	52.5
Atlanta	-0.2456		56.8
Baltimore	-0.4806	**	40.3

* - 10% level of significance
** - 5% level of significance
*** - 1% level of significance

The dissimilarity index varies between 0 and 100, and measures the percentage of one group that would have to move across neighborhoods to be distributed the same way as the second group. A dissimilarity index of 0 indicates conditions of total integration. A dissimilarity index of 100 indicates conditions of total segregation. For more information see www.CensusScope.org of the Social Science Data Analysis Network at the University of Michigan.

Table 14: Impact of Number of Elderly Residents in a Neighborhood

Percent People over 65

Home Purchase

	Estimated coefficient	Level of Significance
Detroit	0.1606	***
Houston	0.1597	***
Atlanta	0.0845	
Cleveland	0.0698	
Washington	0.0415	
Baltimore	0.0367	
New York	0.0245	
Milwaukee	0.0231	
St. Louis	-0.0294	
Los Angeles	-0.0702	*

Refinance

	Estimated coefficient	Level of Significance
St. Louis	0.3065	***
Atlanta	0.2701	***
Houston	0.2483	**
Cleveland	0.1635	***
Baltimore	0.1307	**
Washington	0.1105	***
Los Angeles	0.0756	**
Milwaukee	0.0682	
New York	-0.0054	
Detroit	-0.0634	**

* - 10% level of significance
** - 5% level of significance
*** - 1% level of significance

NCRC Board Members

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NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

September 25, 2003

Office of the Comptroller of the Currency
250 E Street, SW
Public Information Room, Mailstop 1-5
Washington DC 20219

Attention: Docket No. 03-16

To Whom it May Concern:

The National Community Reinvestment Coalition, the nation's CRA and fair lending trade association of 600 community organizations, is extremely disappointed with the OCC's proposal to exempt nationally chartered banks from state anti-predatory law and other critical consumer laws. NCRC believes that preempting consumer protection laws would expose consumers to widespread abusive lending practices. The regulatory standard that the OCC is proposing to replace anti-predatory law is insufficient, as it would permit abusive practices outlawed by state anti-predatory law. The OCC must reverse its course and declare that state anti-predatory law applies to national banks and their operating subsidiaries.

OCC Discretionary Authority to Let State Law Stand

The OCC has the statutory discretion to mandate that state anti-predatory law applies to nationally chartered banks and their subsidiaries. According to 12 USC 1828o, the OCC's regulations "may differentiate among types of (real estate) loans as may be warranted, based on the risk to the deposit insurance fund; or as may be warranted, based on the safety and soundness of the institutions." Because high cost loans pose a greater risk to the safety and soundness of lending institutions, the OCC could therefore rule that Part 34 of their regulations covering real estate lending would not preempt state anti-predatory laws.[1]

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[1] The FDIC has found that although subprime lenders constitute about 1 percent of all insured financial institutions, they account for 20 percent of depository institutions that have safety and soundness problems. Department of Treasury, Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, Proposed Agency Information Collection Activities (Collecting subprime lending information on call reports), Federal Register, May 31, 2000, pages 34801-34819.

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Likewise, the OCC must choose not to amend its Part 7 regulations to preempt state consumer protection laws concerning non-real estate lending and deposit taking activities. States have enacted vital laws establishing protections regarding checking accounts, use of consumer credit reports, credit card practices, abandoned and unused accounts, and escrow procedures. Preempting these state protections and replacing them with few and vague standards eliminates long-standing protections and leaves consumers vulnerable to a large number of new abuses.

OCC Needs to Strengthen its Proposed Regulation

In addition to refraining from preemption, the OCC could also significantly strengthen its proposed consumer protections in Parts 7 and 34. The proposed rules in Parts 7 and 34 state that a national bank shall not make a real estate and non-real estate loan based "predominantly on the foreclosure value of the borrower's collateral, without regard to the borrower's repayment ability." While asset-based lending beyond repayment ability is a fundamental aspect of predatory lending, an abusive loan can still strip equity without leading to delinquency or foreclosure. In other words, a borrower can have the necessary income to afford monthly payments, but he or she is still losing wealth as a result of a lender's excessive fees or unnecessary products.

The OCC could bolster its proposed regulation by adding core principles from its recent anti-predatory Advisory Letters (AL 2003-2 and AL 2003-3) to Parts 7 and 34. In the Advisory Letters, the OCC states that abusive flipping, fee packing, and equity stripping are unfair and deceptive and thus violate the FTC Act. The OCC also reiterates in its Advisory Letters that abusive lending, particularly lending beyond borrower repayment ability, does not meet credit needs and thus will adversely affect CRA ratings.

In order to provide meaningful enforcement, the OCC must incorporate major principles from its Advisory Letters to Parts 7 and 34 of its regulation. Specifically, the OCC must add to its regulations that abusive flipping, fee packing, equity stripping, and other practices shall be prosecuted by the OCC per the FTC Act and that these practices shall also adversely affect CRA ratings. If the OCC then allowed more comprehensive state anti-predatory laws to supercede its regulation, the OCC would respect the democratic decisions of states with strong anti-predatory law while providing the protection afforded in its regulation to states lacking anti-predatory law.

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Intellectual Foundation for OCC's Preemption Order Shaky

Based on the Georgia preemption order, rhetoric contained in the Comptroller's speeches and the OCC working paper on subprime lending, NCRC suspects that the OCC is embarked on a very different course than the approach we recommend. In a speech delivered a week before the preemption order of Georgia law, Comptroller Hawke said that state anti-predatory laws have "overbroad and unintended adverse effects...effects that, as we've seen, can be almost as harmful as the problem those laws were designed to address."[2] In an one-sided and polemical manner, the OCC working paper then attempts to prove that state anti-predatory laws choke off responsible subprime loans, and do not effectively combat abusive practices.

NCRC is distressed at the OCC's aggressive rhetoric and is astounded that the Comptroller would assert that the possibilities of restricting some loans approaches the harm of massive foreclosures and equity stripping caused by predatory lenders. The studies to date present inconclusive and contradictory evidence about the possibilities of anti-predatory laws restricting access to credit. On the other hand, the damage caused by predatory lenders is real and severe.

The OCC's intellectual basis for preempting state law is that "national banks, particularly those with customers in multiple states, face uncertain compliance risks and substantial additional compliance burdens and expense that, for practical purposes, materially impact their ability to offer particular products and services." [3] Therefore, state law cannot stand since state law fundamentally affects national banks' abilities to offer loans and other banking products. Only the OCC, through authority granted by Congress and affirmed by the courts, can regulate banks' lending and other activities.

However, the current evidence and academic research do not support the assertion that state anti-predatory law fundamentally curtails national banks' lending activities. In a paper entitled "Do Predatory Lending Laws Influence Mortgage Lending," Peter Nigro of the OCC and Keith Harvey of Boise State University conclude that North Carolina's anti-predatory law did not affect the subprime market share of loans made to low- and moderate-income borrowers in North Carolina relative to five other Southeastern states. While the authors find a small decrease in the subprime market share to minorities, the

[2] Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the Federalist Society, Washington DC, July 24, 2003.

[3] Preamble of preemption proposal, p. 46120, Federal Register, Vol. 68, No. 150, Tuesday August 5, 2003.

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

change is "significant at the 10 percent level only." In other words, the change for minorities is barely statistically significant. Moreover, Nigro and Harvey find that non-bank mortgage companies decreased their lending to a much greater extent than banks after passage of North Carolina law. This study suggests that national banks have not faced significant constraints nor has their lending been "materially" impacted by passage of state anti-predatory law.[4]

In a more recent study, Professor Michael Stegman and his colleagues at the University of North Carolina concluded that the North Carolina anti-predatory law did not restrict overall access to credit, but did decrease loans with abusive features such as loans with prepayment penalties beyond three years.[5] Ironically, the OCC misinterpreted Stegman's work when the OCC asserted a sharp decline in loans in the wake of North Carolina law. The trade publication, *Inside B& C Lending*, reports that the OCC later issued a clarification acknowledging its mischaracterization of the Stegman study.[6]

NCRC is aware that other studies come to opposite conclusions regarding the impact of anti-predatory laws. Professor Staten of Georgetown University asserts that anti-predatory law reduces the number of subprime loans to traditionally underserved borrowers.[7] Nigro and Harvey conducted another study documenting declines in subprime lending after enactment of anti-predatory law by the cities of Philadelphia and Chicago.[8] These studies, however, suffer significant data and interpretative shortcomings. Staten's study relies on data supplied by a trade association of subprime lenders. Nigro's and Harvey's study does not adequately consider that lenders stopped lending in the two cities for a very short time period in order to pressure the cities and their state governments to nullify the laws.

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[4] "Do Predatory Lending Laws Influence Mortgage Lending? An Analysis of the North Carolina Predatory Lending Law," September 2002, Keith D. Harvey, Boise State University, and Peter J. Nigro, OCC, see pg. 14 and 25.

[5] "The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment," Roberto G. Quercia, Michael A. Stegman, and Walter R. Davis, June 25, 2003, the Center for Community Capitalism, University of North Carolina at Chapel Hill.

[6] "OCC Admits NC Slip-Up, but Did Anyone Notice," Inside B&C Lending, August 18, 2003.

[7] "Regulation of Subprime Mortgage Products: An Analysis of North Carolina's Predatory Lending Law," October 2002, Gregory Elliehausen and Michael Staten, McDonough School of Business, Georgetown University.

[8] "How Do Predatory Lending Laws Influence Mortgage Lending in Urban Areas? A Tale of Two Cities," Keith D. Harvey and Peter J. Nigro, March 2002.

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Regardless of whose studies are viewed with more credibility, it is beyond doubt that an impartial observer would conclude that the current level of academic research does not support the bold assertions and actions of the OCC. For each study that asserts impairment of national bank lending, another study discounts that possibility. Moreover, only one study, Stegman's, examines the types of loans affected by anti-predatory law. Based on his study, state anti-predatory law eliminates the loans that the OCC cautions against in its Advisory Letters. Until more studies are conducted with more detailed data on loan terms and conditions, the most reasonable conclusion is that state anti-predatory laws stops abusive lending beyond borrowers' repayment abilities instead of causing large scale reductions in loans made by national banks. At the very least, the OCC must allow for more study and careful examination before rushing to nullify state anti-predatory law.

Intellectual Basis of Preemption Proposal Shaky, But Consequences Real

Another compelling reason for caution as opposed to an aggressive preemption is the considerable presence of national banks in the lending marketplace. Using CRA Wiz software produced by PCI Services, Inc., NCRC calculates that OCC-regulated institutions made 4,479,087 single-family loans or about 28 percent of all single family loans reported under HMDA. Any OCC preemption will thus have profound impacts on the market and on the scope of protection against abusive lending.

While the OCC boasts that national banks are not involved in predatory lending to any discernible degree, NCRC finds it implausible that a group of lenders representing nearly one third of the marketplace are involved, purposefully or unwittingly, in only a marginal amount of abusive activity. NCRC has been engaged in a Consumer Rescue Fund (CRF) program, under which we arrange affordable "rescue" loans for borrowers confronting foreclosure, bankruptcy, or other financial difficulties due to predatory lending. In the course of our CRF program, we provided assistance to Maxine Wilson, who spearheaded a lawsuit involving more than 400 families in New York state against a number of financial institutions and real estate developers. The lawsuit also involves national banks. In this case, the national banks did not make the predatory loans, but they purchased them.[9]

[9] "400 Families Sue Builder: Class Action Discrimination Case Also Names Lenders," Carrie Mason-Draffen, Newsday, July 11, 2001.

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

The OCC's own enforcement efforts reveal a considerable amount of abusive practices by national banks. In June of 2000, the OCC ordered Providian National Bank to pay $300 million to hundreds of thousands of customers who were harmed by unfair and deceptive practices. Providian employed classic bait and switch tactics. The bank had promised that customers would not have to make credit card payments for up to 18 months in the case of involuntary unemployment, hospitalization, or sickness. But the bank did not tell customers that the actual number of months of forgiveness was usually much less than 18 months and depended on the number of months in which customers had paid fees for the forgiveness program.[10] In another case in 2001, the OCC ordered Direct Merchants Credit Card Bank, NA to pay $3.2 million to 62,000 customers. These customers thought they had signed up for an unsecured card with no annual fee; they discovered instead that the cards required a deposit, a $30 annual fee, and had a higher interest rate than advertised.[11]

Lastly, in a speech in 1999, the Comptroller of the Currency denounced the practice of certain lenders not reporting favorable payment history to the credit bureaus. This practice trapped borrowers in higher cost loans since the borrowers could not demonstrate on-time payments according to the Comptroller. Although the Comptroller did not name any banks in his speech, it is very likely that this practice came to the attention of the OCC during their examinations of nationally chartered banks.[12]

As these examples illustrate, it would be more prudent for the OCC to jointly enforce anti-predatory law with state officials than to wipe out state law and enforcement. National banks represent too large of a segment of the marketplace to be entrusted to one regulatory agency, which has argued in recent years that its sources of revenues have not kept pace with its regulatory responsibilities.[13]

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[10] Office of the Comptroller of the Currency Press Release and Fact Sheet, June 28, 2000, *Providian to Cease Unfair Practices, Pay Consumers Minimum of $300 Million Under Settlement with the OCC and San Francisco District Attorney*, via http://www.occ.treas.gov.

[11] Office of the Comptroller of the Currency Press Release and Fact Sheet, May 15, 2001, *OCC Announces 10 New Enforcement Actions and 2 Terminations*.

[12] Remarks byJohn D. Hawke, Jr. Comptroller of the Currency, Before a Conference Sponsored by the Consumer Bankers Association Robert Morris Associates San Francisco, California, June 7, 1999

[13] Remarks by John D. Hawke Jr., Comptroller of the Currency, before the University of North Carolina School of Law, Charlotte, North Carolina, April 5, 2001.

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

The OCC ponders in its preemption proposal whether it should occupy the entire field of banking law, prohibiting states from enacting any law that governs national bank activities. Given the meager evidence of state infringement of national bank lending activities, such a proposal is unwarranted and counterproductive. The OCC's occupation of the field would eliminate state law such as North Carolina's that are effective in combating predatory lending.

Because of the stark realities of predatory lending, NCRC urges the OCC to change course. The OCC must not preempt state anti-predatory law. Instead, it must strengthen the consumer protection aspects of its proposed changes to Parts 7 and 34 of its regulations. The OCC can choose to protect communities and consumers. Alternatively, it can issue audacious and complete preemptions based on flimsy evidence and heated rhetoric about the ills of anti-predatory law. NCRC hopes the OCC sides with the consumers and hard-working homeowners in America.

Thank you for this opportunity to comment on this important matter. Please feel free to contact me or Josh Silver, Vice President of Research and Policy, on 202-628-8866.

Sincerely,

John Taylor

John Taylor
President and CEO

STATEMENT OF

THE FINANCIAL SERVICES ROUNDTABLE

TO

THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

OF

THE U.S. HOUSE OF REPRESENTATIVES

JANUARY 28, 2004

Chairwoman Kelly, Ranking Member Gutierrez, and the members of the Subcommittee, The Financial Services Roundtable (The Roundtable) is pleased to submit this testimony to the Subcommittee on Oversight. The Roundtable is a national association of 100 of the Nation's largest integrated financial services firms, whose members engage in banking, securities, insurance, and other financial services activities.

The Financial Services Roundtable strongly supports the preemption regulations issued by the Office of the Comptroller of the Currency. Our members believe that these regulations are based on solid legal precedent and sound policy considerations. The application of these regulations will benefit and protect consumers, provide national banks with strong and consistent regulation, and preserve the dual banking system under which institutions with state and federal charters will continue to flourish.

The Roundtable Supports the Regulations

The Roundtable strongly supports the preemption regulations issued by the OCC. We do so for several reasons.

- The regulations benefit and protect consumers;
- The regulations free national banks from a cycle of litigation by clearly identifying the types of laws that should apply to the operations of national banks and the types of laws that should not;
- The regulations are balanced. They preempt only those laws that interfere with the basic banking operations of national banks, not all state laws;
- The regulations are consistent with federal law and judicial precedent; and
- The regulations preserve the dual banking system.

The OCC Regulations Benefit and Protect Consumers

Like the recently extended preemption provisions in the Fair Credit Reporting Act, the preemption regulations issued by the OCC have a significant beneficial impact on consumers. They permit national banks to interact with a consumer on a uniform basis, no matter where the consumer is located. They also permit national banks to offer products and services more efficiently and conveniently to consumers.

The regulations also protect consumers. Imbedded in the regulations are two anti-predatory lending standards. In conjunction with existing federal consumer protection laws and OCC advisories, these standards protect consumers against many, if not most, of the abuses that are addressed in state anti-predatory lending statutes. Table 1 provides a partial illustration of the scope of this protection. It shows that the OCC's regulations, in conjunction with federal consumer protection laws, address many of the practices that are addressed in state anti-predatory lending laws. Unlike state laws, however, these standards apply to all national banks, regardless of where they operate, and they apply even if a state law is silent on a particular practice.

Table 1

Some of the Practices Prohibited by OCC Regulations and Existing Federal Consumer Protection Laws

Foreclosure or Liquidation Value Lending in which a loan is made on the basis of the foreclosure or liquidation value of the collateral securing the loan (e.g., a home).
Loan Flipping that results in little or no economic benefit to borrower.
Loan Packing of excessive or hidden fees.
Balloon Payments that conceal the true burden of the financing.
Equity Stripping as a result of excessive financed feed or high prepayment penalties.
Loan Steering on the basis of race, national origin, age or gender.
Negative Amortization in connection with high cost mortgages.

Inadequate Disclosure of true costs of loan.
Any Other Unfair or Deceptive Practice under Section 5 of the Federal Trade Commission Act.

Critics of the OCC's preemption regulations question the ability of a federal agency to monitor and enforce compliance with these standards and applicable consumer protection laws. National banks that are subject to OCC supervision tell a different story. Today, the OCC has approximately 1,800 examiners who are responsible for examining approximately 2,200 banks. As a matter of policy, all national banks are subject to a full-scope examination at least every 18 months. This includes not only a safety and soundness review, but also a review for compliance with consumer protection laws and regulations. Moreover, as a practical matter, fewer than 75 of the 2,200 national banks have assets over $1 billion. Thus, the OCC is able to allocate the majority of its examiners to the national banks most likely to be engaged in nationwide lending or complex activities, and the largest banks have teams of resident examiners that are located on-site.

The OCC has recognized that state authorities may become aware of consumer complaints involving national banks. Therefore, last year, the OCC proposed that state banking regulators and attorney generals share information about consumer complaints involving national banks. This proposal was patterned after agreements the OCC has entered into with 48 state insurance regulators, which have proven to be quite successful. We understand, however, that no state attorney general or banking supervisor has agreed to share consumer complaint information with the OCC. We believe it would be productive if the states entered into cooperative agreements with the OCC to notify the OCC of consumer complaints the states may receive.

Finally, there is simply no evidence to indicate that the OCC is not adequately monitoring the activities of national banks or enforcing applicable consumer protection laws. In fact, when it comes to predatory lending, there is evidence that the OCC is doing its job. Last year, 22 state attorney generals filed a brief in federal court in which they stated that predatory lending abuses "are largely confined to the subprime mortgage lending market and non-depository institutions." (Brief of Amicus Curiae State Attorneys General In Opposition to Plaintiff's Motion for Summary Judgment and In Support of Defendant's Motion of Summary Judgment; National Equity Mortgage Assn. v. OTS, Civil Action No. 1: 02cv02506 (GK), U.S. District Court for the District of Columbia, page 10.) In other words, these state officials, including the attorney generals for the States of New York and Ohio, have found that predatory lending is not caused by institutions regulated by the OCC and the other federal banking agencies.

The OCC Regulations Free National Banks from a Costly, and Time-Consuming, Cycle of Litigation

The OCC's preemption regulations free national banks from a costly, and time-consuming, cycle of litigation. During the past several years, national banks have been forced to respond to a growing number of state and local initiatives aimed at regulating their activities and operations. Recently, for example, Iowa attempted to restrict the operation of ATMs by banks headquartered outside the state. Also, just last year, several California jurisdictions attempted to prohibit banks from charging ATM fees to non-depositors.

In these, and other similar cases, national banks have been forced to turn to federal courts to preserve the integrity of the national banking system against state regulation. Federal courts have sided consistently with national banks in these cases, yet the cycle of litigation has

continued, driven in part by the fact that there are thousands of state and local jurisdictions with legislative authority.

The regulations issued by the OCC bring an end to this cycle. They do so by establishing a framework that clearly defines the types of state laws that should apply to the activities and operations of national banks and those that should not.

The OCC's Regulations Take a Balanced Approach to Federal Preemption

The OCC has taken a very balanced approach in drawing the line between those state laws that should apply to national banks and those that should not. The regulations preempt only those state laws that interfere with the basic banking activities of national banks, not those state laws that generally apply to any citizen or corporation. For example, the regulations preempt state laws that relate to checking accounts, savings accounts, credit terms, loan origination and loan processing. On the other hand, they do not preempt state contract laws, state criminal laws, state property, tax or zoning laws.

In other words, the OCC has drawn a line around the basic banking activities of a national bank and said that these activities are governed exclusively by federal law. At the same time, the OCC has acknowledged that a national bank, like any citizen, must be subject to certain, basic state laws, such as state contract and criminal laws.

The OCC Regulations Are Consistent with Federal Law and Congressional Intent

The regulations issued by the OCC are consistent with federal law and Congressional intent. National banks, and the OCC, were created in 1863 with the passage of the National Bank Act. Thus, the authority for the actions taken must be found in the National Bank Act.

Both the specific terms of the National Bank Act and the legislative history accompanying the Act indicate that Congress intended the authorized activities of national banks to be governed by federal law, not state law.

Among the specific provisions of the National Bank Act upon which the OCC regulations are based are the following:

- 12 U.S.C. 24 (Seventh). This provision of the National Bank Act is a broad grant of authority for national banks to engage in "all incidental powers as necessary to carry out the business of banking." This is the foundation for a uniform system of regulation for national banks.
- 12 U.S.C. 93a. This provision of the National Bank Act gives the OCC the broad authority to "prescribe rules and regulations to carry out the responsibilities of the office."
- 12 U.S.C. 371 is a specific grant of authority in the National Bank Act for national banks to make mortgage loans "subject to such restrictions and requirements as the OCC may prescribe by rule or order."
- 12 U.S.C. 484 states that no national bank shall be subject to examination and supervision, except as authorized by federal law or the courts.

The legislative history of the National Bank Act also indicates that Congress intended the national banks to operate without undue interference by the states. The National Bank Act was proposed by President Lincoln and his Secretary of the Treasury, Salmon Chase, when the nation was engaged in the Civil War. They recognized that, at that time, our country needed a system of national banks to finance industrial growth and development. Initially, Congress assumed that this national banking system would replace the then existing system of state banks. Thus, in the

debate over the Act, it is clear that Congress envisioned a system of banking that was independent of state regulation. As we all know, national banks did not replace state banks. Instead, our dual banking system evolved, and today, state banks still outnumber national banks 3 to 1. President Lincoln's vision for a system of national banks, however, is just as valid today as it was in 1863. In fact, one could easily argue that given the development of our economy, the need for a national banking system to help meet the financial needs of businesses and consumers is even greater today than it was 140 years ago.

Additionally, when Congress passed the Riegle-Neal Interstate Banking and Branching Act in 1994, it affirmed the preemptive power of the National Bank Act. While the Riegle-Neal Act subjects the interstate branches of national banks to state consumer protection laws, it provides that such state laws do not apply to national banks "when Federal law preempts the application of such laws." (See 12 U.S.C. 36(f)(1)(A)(i)) Also, the legislative history accompanying the Riegle-Neal Act states that the Act "does not change judicially established principles [of preemption]," including conflict preemption, upon which the OCC regulations are based.

The OCC Regulations Are Consistent with Judicial Precedent

The preemption regulations are consistent with judicial precedents that span over a century. In 1896, for example, the U.S. Supreme Court noted the following when it found that a New York State law establishing preferences for creditors of an insolvent bank should not apply to national banks:

> National banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States.

> It follows that an attempt, by a state, to define their duties or control the conduct of their affairs is absolutely void, whenever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiencies of the agencies of the Federal government to discharge the duties, for the performance of which they were created. (Davis v. Elmira Saving Bank, 161 U.S. 275)

One hundred years later, in a case involving a Florida law that prohibited banks from selling insurance, the U.S. Supreme Court came to the same conclusion. In that case, the court noted that the history of the National Bank Act "is one of interpreting grants of both enumerated and incidental powers to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law." (Barnett Bank v. Nelson, 517 U.S. 32)

Additionally, a federal court settled the question of the OCC's authority to issue regulations preempting state law over twenty years ago. In 1983, the U.S. Court of Appeals for the District of Columbia upheld the preemptive effect of a real estate regulation issued by the OCC. In so doing, the court emphasized the limitations of state laws on national banks:

> It bears repeating that the entire legislative scheme is one that contemplates the operation of state law only in the absence of federal laws and where such state law does not conflict with the policies of the National Bank Act. So long as he does not authorize activities that run afoul of federal laws governing the activities of national banks, therefore, the Comptroller has the power to preempt inconsistent state law. (Conference of State Bank Supervisors v. Conover, 710 F. 2d 878)

Finally, pursuant to pre-existing OCC regulations, these new preemption regulations apply not only to national banks, but also to operating subsidiaries of national banks. National banks

have long been permitted to engage in banking activities through operating subsidiaries, and Congress explicitly recognized their existence in the Gramm-Leach-Bliley Act. Unlike the financial subsidiaries created in the Gramm-Leach-Bliley Act, however, operating subsidiaries may engage only in those activities permissible for a parent national bank. (Since financial subsidiaries can engage in non-banking activities, such as insurance sales, the preemption regulations do not apply to financial subsidiaries.) Moreover, the activities of operating subsidiaries are consolidated with the parent bank for accounting, regulatory reporting, and examination purposes. Thus, for all practical purposes, operating subsidiaries are departments of a bank, and most are physically located in the parent bank. As a result, the Federal Court of Appeals for the Ninth Circuit recently upheld the application of federal preemption to operating subsidiaries of national banks. (See Wells Fargo v. Demetrios, 265 F. Supp. 2nd 1162 (E.D.Cal.))

Based upon these judicial precedents, we have no doubt, therefore, that should the preemption regulations be challenged in federal court, they will withstand that challenge.

The OCC's Regulation Preserves the Dual Banking System

The dual banking system consists of two, separate systems for chartering and supervising banks. There is a natural tension that arises between these two systems. This natural tension has not produced a "race to the bottom" in regulation, but a "race to the top." It has resulted in the authorization of new products and services in response to changing consumer needs and demands, and it has stimulated improvements in examination procedures and supervisory systems. Nonetheless, without federal preemption, it is fair to conclude that this natural tension would lead states to gradually subject national banks to the same regulations applicable to their banks, and the distinctions between state and national banks would disappear. This would bring

an end to the dual banking system. Therefore, the regulations do not jeopardize the dual banking system, they help to preserve it.

Federal Preemption Affects All Financial Services Firms

While the OCC's regulations apply to national banks, the principles embodied in these regulations are important to all members of The Roundtable. Many Roundtable members currently depend upon federal preemption to conduct basic business activities. For example –

- State chartered banks rely upon federal preemption to extend credit outside their home states. State chartered banks also understand that there would be no dual banking system without federal preemption.
- Federally chartered savings associations accept deposits and make loans under federal preemption regulations that are almost identical to those just issued by the OCC. Those regulations have been in effect for years.

Other members of The Roundtable see federal preemption as a key to the provision of better financial products and services to consumers.

- Federal preemption is a central feature of a proposed optional dual insurance chartering system that would improve the development and delivery of insurance products and services by allowing insurers that operate nationwide to comply with one, uniform set of regulations, not 50.
- Federal preemption is a necessary component of federal anti-predatory lending legislation, such as Representative Ney's Responsible Lending Act, which would establish a uniform, national standard for mortgage lending for all lenders.

Therefore, although the focus of this hearing is on the preemption regulations issued by the OCC, The Roundtable urges the Subcommittee to recognize the importance of federal preemption to the entire financial services industry and the stability, consistency it provides to the consumers of financial products and services.

Federal preemption permits financial services firms that operate on a multi-state basis to comply with a single set of regulations. This, in turn, permits financial services firms not only to interact with consumers on a uniform basis, but also to offer financial products and services more efficiently – and potentially more cheaply – because they do not have to comply with multiple state and local requirements.

Federal preemption also is vital to our national economy. Economic growth depends upon financial institutions that can serve businesses that operate nationally and consumers that move from state to state, and federal preemption facilitates the development of national financial institutions.

Congress has recognized the benefits of federal preemption for the consumers of financial services on many occasions, most recently in the renewal of the Fair Credit Reporting Act. The preemption provisions in that Act, which Congress just made permanent, permitted the establishment of a uniform, national credit reporting system that serves as a foundation for our national consumer credit system. Similarly, in the Gramm-Leach-Bliley Act, Congress preempted all state laws that prevent or restrict all banks – state and national – from engaging in activities authorized by that Act.

The Roundtable urges the members of this Subcommittee to recognize the benefits of federal preemption to the entire financial services industry.

Conclusion

In summary, The Roundtable strongly supports the OCC's federal preemption regulations. They are good for consumers and the economy. They are consistent with existing federal law and legal precedents, and they help to preserve the dual banking system. The OCC's regulations are appropriate and justified for the effective regulation of national banks.

The Roundtable also asks the Subcommittee to keep in mind the benefits that federal preemption provides to enable financial services to be efficiently provided to all consumers across the nation. The Financial Services Roundtable and its member companies want to work with the Financial Services Committee on all aspects of this issue in the future. Thank you.

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October 6, 2003

Via Facsimile: (202) 874-4448

Office of the Comptroller of the Currency
250 E Street, S.W., Public Information Room, Mailstop 1-5
Washington, DC 20219

Re: Docket No. 03-16, 12 CFR Parts 7 and 34.

Dear Sir or Madam:

We, the undersigned Attorneys General of 50 States and the Virgin Islands and the District of Columbia Office of Corporation Counsel, submit the following Comments on the rules proposed by the Office of the Comptroller of the Currency in Docket No. 03-16. As the chief law enforcement officials of our respective jurisdictions, we strongly oppose these preemption rules and urge the OCC to defer further action on them.

The OCC's current proposal, coupled with other recent OCC pronouncements on preemption, represents a radical restructuring of federal-state relationships in the area of banking. In recent years, the OCC has embarked on an aggressive campaign to declare that state laws and enforcement efforts are preempted if they have any impact on a national bank's activities. The OCC has zealously pushed its preemption agenda into areas where the States have exercised enforcement and regulatory authority without controversy for years.

The OCC's preemption analysis is one-sided and self-serving. The OCC has paid little deference to well-established history and precedent that has allowed the States and the OCC to coexist in a dual regulatory role for over 130 years. That precedent has upheld this nation's policy that national banks are subject to state laws unless the state laws significantly impair the national bank's powers created under federal law. The OCC is destroying that careful balance by finding "significant interference" or "undue burden" whenever state law has <u>any</u> effect on a national bank.

The States acknowledge that the National Bank Act preempts some state laws, such as regulation of credit card interest rates charged by out-of-state national banks.[1] Particularly in the area of consumer protection, however, there are state laws that affect virtually all commercial entities doing business with the public, including banking institutions. These laws do not impose significant burdens on national bank activities and are applied evenhandedly throughout the marketplace. As a general rule, state consumer protection laws prohibit businesses from engaging in unfair or deceptive practices. These laws are consistent with Section 5 of the Federal Trade Commission Act, and the States traditionally have enforced them in a wide range of financial activities involving consumers. A national bank's compliance with these laws should be expected and welcomed by the OCC, not regarded as a "significant impairment" of the bank's federal rights. It would be unprecedented and unfair to grant national banks (including, in the OCC's view, affiliated nonbank institutions) total immunity from all state consumer protection regulation and enforcement.

In the area of predatory mortgage lending, the OCC's actions are particularly disappointing. The States have taken a leadership role in devising legislation to restrict abusive practices in home equity lending. These state laws were carefully crafted to avoid preemption issues, to create safe harbors for mortgage lenders, and to add consumer protections to high cost subprime loans. In the States' experience, these laws have worked. Instead of commending the States' efforts, the OCC has gone to great lengths to attack them and to declare that they are inapplicable to national banks and their operating subsidiaries. In their place, the OCC has recommended minimal protections that fail to address many of the worst predatory lending abuses.

The States would prefer to cooperate and partner with the OCC, especially when enforcement resources are limited. The States and the OCC share similar goals of protecting the public and providing for a fair credit marketplace. But instead of seeking cooperation and joint enforcement, the OCC is insisting on an exclusive regulatory regime that would eliminate the role of the States, particularly with respect to such important consumer protection issues as predatory mortgage lending and telemarketing abuses. There is much work to be done by all regulatory and enforcement agencies on real and pressing problems. The States submit that this is not the time to devote energies to turf battles and empire building.

A. National Banks Historically Have Been Subject to State Laws and a Dual System of Enforcement.

The OCC's recent campaign to obtain exclusive enforcement authority over its constituent national banks, and to shield the banks from virtually all state laws, ignores a longstanding tradition of federal and state enforcement. Under this dual system, federal authorities have overseen the business activities of national banks to ensure the "safety and soundness" of banking institutions. The States, for their part, have enforced state laws of general application against all persons and businesses within their borders, including national banks. This complementary system of state and federal enforcement has worked well, both to maintain safe and sound banking practices, and to protect the consuming public from deleterious business practices. The dual system has roots not only in actual enforcement experience, but also in U.S. Supreme Court and other judicial precedents as

[1] Marquette National Bank v. First of Omaha Service Corp., 439 U.S. 299 (1978).

well as Congressional pronouncements recognizing the vital role of the States in monitoring business activities within their borders.

1. Under Supreme Court Precedent, National Banks Are Subject to State Laws that Do Not Conflict With, or Substantially Impair, Bank Rights under Federal Law.

The National Bank Act ("NBA"), on which the OCC heavily relies to augment its powers, is a Civil War-era statute that was intended to finance the war and restore control of the monetary system to the federal government.[2] Contrary to the OCC's current assertions, the NBA was not intended to divest all state authority over national banks. Indeed, from its earliest decisions involving the NBA, the U.S. Supreme Court has recognized and upheld the applicability of state laws to national banks. In 1870, the Supreme Court rejected a preemption challenge to a state's collection of a bank shares tax, declaring that national banks "are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional."[3] In McClellan v. Chipman,[4] the Court rejected a bank's "assertion that national banks in virtue of the [NBA] are entirely removed, as to all their contracts, from any and every control by the state law," holding instead that state laws govern the business transactions of national banks except in areas where Congress expressly preempts state law or state law would impair the banks' efficiency in carrying out their duties imposed by federal law. Other Supreme Court decisions affirm the principle that national banks remain subject to many state laws.[5]

In general, the Supreme Court has upheld state laws that 1) did not expressly conflict with the statutory powers of national banks; 2) did not discriminate against national banks; or 3) did not impose undue burdens on the performance of bank functions mandated or permitted under national banking laws. Where the Court has found preemption, it usually has been in instances where the state law either prohibited or significantly impaired an express statutory power of a national bank.

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[2] Act June 3, 1864, ch. 106, 13 Stat. 99.

[3] National Bank v. Commonwealth, 76 U.S. (9 Wall.) 353, 361-62 (1870).

[4] 164 U.S. 347, 359 (1896).

[5] See, e.g., Davis v. Elmira Savings Bank, 161 U.S. 245, 290 (1896) ("Nothing, of course, in this opinion is intended to deny the operation of general and undiscriminating state laws on the contracts of national banks, so long as such laws do not conflict with the letter or the general objects and purpose of Congressional legislation."); First National Bank in St. Louis v. Missouri, 263 U.S. 640, 656 (1924) (National banks "are subject to the laws of a State in respect of their affairs unless such laws interfere with the purposes of their creation, tend to impair or destroy their efficiency as federal agencies or conflict with the paramount law of the United States."); Anderson National Bank v. Luckett, 321 U.S. 233, 244-52 (1944) ("National banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions," holding that a state statute administering abandoned deposit accounts did not "unlawful[ly] encroac[h] on the rights and privileges of national banks."); Franklin National Bank v. New York, 347 U.S. 373, 378 n.7 (1954) ("National banks may be subject to some state laws in the normal course of business if there is no conflict with federal law."). More recently, in the 1997 case, Atherton v. FDIC, 519 U.S. 213, 222-23, the Supreme Court reaffirmed the principle that "federally chartered banks are subject to state law," based on its earlier decisions.

The Supreme Court's 1996 decision in Barnett Bank of Marion County, N.A. v. Nelson[6] is consistent with these principles. In Barnett, the Court struck down a Florida law restricting the sale of insurance by national banks because a federal statute granted national banks the right to sell insurance in towns of 5,000 or fewer. The Court stated that preemption would be found if there was a direct conflict with express federal statutory authority because "normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted."[7] However, the Court went on to stress that the preemption test was not intended "to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank's exercise of its powers."[8]

Therefore, the test to determine whether a state law is preempted when applied to a national bank focuses on whether there is a "significant impairment" of a bank's express rights under federal law or a "significant interference" with the legitimate functions of a bank. This test reflects the traditional standard for conflict preemption in that only those state laws significantly interfering with a bank's exercise of its powers are preempted.

Lower court decisions also have recognized and affirmed the general applicability of state laws to national banks. For example, in Video Trax, Inc. v. NationsBank, N.A.,[9] the U.S. District Court for the Southern District Court of Florida observed: "Banking is not an area in which Congress has evidenced an intent to occupy the entire field to the exclusion of the states, and thus, state legislatures may legislate in all areas not expressly or impliedly preempted by federal legislation."

The OCC's current approach to conflict preemption flies in the face of these judicial precedents; it is so sweeping that, in reality, the OCC is establishing a regime of field preemption. The OCC presupposes that any state law that can arguably "impair the efficiency" of national bank lending operations compels a finding of preemption. Under this theory, most state consumer protection laws would be preempted, since such laws are unlikely to provide any protection without having some incidental impact on a bank's "efficiency." The OCC should not, by expansively interpreting the terms "impair significantly" and "significant interference," undertake to overturn over 130 years of precedent establishing that national banks are not entitled to immunity from all state laws and regulation.

2. Congressional Intent Supports the Applicability of State Law to National Banks and the Presumption against Preemption.

In 1994, Congress enacted the Riegle-Neal Interstate Banking and Branching Efficiency Act to permit national banks to operate interstate branches to better serve consumers. In enacting the legislation, Congress made a clear pronouncement of its intent that state law would continue to apply to the interstate operations of national banks, particularly in the area of consumer

[6] 517 U.S. 25 (1996).
[7] Id. at 33.
[8] Id.
[9] 33 F. Supp. 2d 1041, 1048 (S.D. Fla. 1998), aff'd per curiam, 205 F.3d 1358 (11th Cir.), cert. denied, 531 U.S. 822 (2000).

protection. The report of the House-Senate conference committee on the Riegle-Neal Act noted that "[u]nder well established judicial principles, national banks are subject to state law in many significant respects."[10] The report emphasized:

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses and communities. Congress does not intend that the Interstate Banking and Branching Efficiency Act of 1994 alter this balance and thereby weaken States' authority to protect the interests of their consumers, businesses, or communities.[11]

On the question of whether state laws may be preempted by federal banking law, the Conference Report noted that courts generally have applied "a rule of construction that avoids finding a conflict between Federal and State law where possible."

The OCC appears tone deaf to the Congressional message sent by Riegle-Neal. The OCC discounts Riegle-Neal's legislative history by noting that the Act excluded from its coverage those state laws that were preempted by federal law. While this statement is correct, the OCC ignores the fact that in 1994, when Riegle-Neal was enacted, it was generally accepted that most state consumer protection laws (outside of usury regulation) were not subject to preemption. Now that the OCC is taking the position that essentially all state consumer protection laws are preempted as to national banks, it contends that the Riegle-Neal mandate on the continued applicability of such state laws has no import. Surely, Congress did not anticipate that its stated intent could be displaced by the OCC pushing the boundaries of preemption off the map.

B. The OCC Has Established an Aggressive Pattern of Advocating Preemption of State Laws.

The OCC has, of late, undermined Congressional intent and the historic federal-state balance by promoting preemption and exclusive OCC control at every opportunity. In recent court appearances, policy statements, opinion letters and proposed rules, the OCC has articulated an intent to exempt its bank clientele from any duty to comply with state law or state consumer protection enforcement. The OCC's efforts have included reducing the traditional "significant interference" test to one of "impairing the efficiency" of a national bank; construing the "visitorial powers" of the OCC[12] to exclude any state enforcement of state laws; and using the "incidental powers" granted national banks under the NBA[13] as a catch-all preemption provision.

The OCC has been candid about its desire, for the benefit of its constituent national banks, to sweep aside the nuisance of state laws: "The ability of a national bank to conduct a multistate business subject to a single uniform set of federal laws, under the supervision of a

[10] H.R. Rep. No. 103-651, reprinted in 1994 U.S. Code Cong. & Ad. News 2068, 2074 (emphasis added).
[11] Id.
[12] 12 U.S.C. § 484.
[13] 12 U.S.C. § 24 (Seventh)

single regulator, free from the visitorial powers of various state authorities, is a major advantage of the national charter. . . ."[14] The Comptroller has stated that the power to override state law "is one of the advantages of a national charter and I'm not the least bit ashamed to promote it."[15]

The OCC has been an assertive advocate in persuading most federal courts to ratify its aggressively expansive preemption policy.[16] In all of the recent decisions cited by the OCC as background for the proposed rule, federal courts found in favor of the OCC's position on preemption. This is hardly surprising, given the OCC's aggressive advocacy role in the federal courts.

Under the Chevron doctrine,[17] federal courts give substantial deference to federal regulatory agencies when interpreting laws enforced by those agencies. Pursuant to the Supreme Court's directive in Chevron, federal courts must exercise restraint in substituting their own construction of a statute for a "reasonable" interpretation by the appropriate agency administrator. The OCC has taken full advantage in exploiting this judicial deference, as have its regulated entities. In banking regulatory cases raising preemption issues, the OCC has repeatedly filed amicus briefs that uniformly promote the interests of the major national banks and oppose state consumer protection interests. Although some courts have questioned the OCC's motives,[18] most courts have felt bound to follow the OCC's preemption interpretations under the Chevron doctrine.

For example, in Bank One, Utah v. Guttau,[19] the OCC sided with a national bank and against the State of Iowa in opposing a state statute requiring that ATM owners maintain an Iowa office and that ATMs display the name, address and phone number of the owner. This latter requirement, intended to give consumers access to information that could help them resolve ATM operational problems, was characterized by the dissent as "a straightforward consumer protection measure."[20] Although the District Court found that the OCC's interpretation of the NBA was "unreasonable,"[21] the Eighth Circuit adopted the OCC's preemption position. In Metrobank v. Foster,[22] the OCC supported another national bank in opposing Iowa's prohibition against charging ATM fees that exceed the "interchange fees" paid to financial institutions by non-account holders.

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[14] OCC News Release 2002-10.

[15] "Dependent on Lender's Fees, the OCC takes Banks' Side Against Local Laws," Wall Street Journal, 1/28/02.

[16] One exception is the case of Bowler v. Hawke, 320 F.3d 59, 62-63 (1st Cir. 2003). The First Circuit found that an opinion issued by the OCC, which purported to declare certain Massachusetts insurance laws as preempted by the Gramm-Leach-Blilely Act, was "no more than informal agency guidance to banks and other interested parties," and did not "create a 'regulatory conflict' giving rise to a case or controversy . . ."

[17] Chevron, U.S.A., Inc., v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984)

[18] Wells Fargo Bank of Texas, N.A. v. James, 321 F.3d 488, 494 (5th Cir. 2003)

[19] 190 F.3d 844 (8th Cir. 1999), cert. denied sub nom. Foster v. Bank One, Utah, 529 U.S. 1087 (2000).

[20] Id. at 851

[21] Bank One, Utah v. Guttau, 1998 U.S. Dist. Lexis 14830 (S.D. Iowa, 1998).

[22] 193 F. Supp. 2d 1156 (S.D. Iowa 2002).

This year, in the case of Wells Fargo v. James,[23] the OCC again argued in support of a group of national banks opposed to a Texas consumer protection law. At issue in that case was a "par value" statute that prohibited any Texas bank from charging fees to cash checks drawn on that bank (known as "on us" checks). Texas contended that such check cashing charges fell disproportionately on the working poor, who often did not have their own bank at which to cash paychecks. Although the Fifth Circuit found in favor of the OCC's preemption position, it expressed concerns about the OCC's role:

> Here, the constituency positively affected by the OCC's position is concentrated, organized and well-funded, and also happens to be the regulated industry. In contrast, the constituency which is adversely affected by the decision, though vast, is diffuse, unorganized, and definitionally ill-funded. It may be that these competing interests could better be balanced, as Appellant suggests, by a national Congress whose commitments are diverse and universal, or even by the people as they are represented in the state legislatures, than by a solitary institution whose focus is a single industry.[24]

The breadth of the OCC's preemption position is revealed in recent interpretative letters issued by the Comptroller. In May 2001, the OCC issued opinions overriding Ohio and Michigan motor vehicle regulatory laws. In the Ohio opinion, the OCC authorized national banks to conduct sales of returned lease vehicles without complying with Ohio sales licensing laws.[25] Ohio law was preempted, according to the OCC, because the bank was authorized to sell the vehicles "in the manner most economically beneficial." In the Michigan opinion, the OCC found that a car dealer is not subject to the State's motor vehicle sales financing laws if a national bank is financing the sale.[26]

C. The OCC's Preemption Actions Interfere with State Consumer Protection Enforcement.

In addition to claiming that most state laws are inapplicable to national banks, the OCC essentially contends that the States do not have any consumer protection enforcement jurisdiction over national banks. The OCC does have explicit "visitorial powers" over national banks pursuant to the NBA.[27] The States therefore may not conduct bank examinations or engage in the direct supervision of a national bank. The OCC, however, is seeking to stretch the meaning of visitorial jurisdiction to block all investigations and enforcement actions directed at national banks.

The OCC has recently advised national banks to notify it if any bank is contacted by a state official, even if the state official is simply seeking information.[28] And although the visitorial powers provision in the NBA contains an express exemption for litigation ("except as ... vested in the courts of justice"), the OCC, in a recent proposed rule on visitorial powers,[29] dismisses the States' right to

[23] 321 F.3d 488 (5th Cir. 2003).
[24] Id. at 494.
[25] 66 Fed. Reg. 23977 (5/10/01).
[26] 66 Fed. Reg. 28593 (5/23/01).
[27] 12 U.S.C. § 484.
[28] OCC Advisory Letter 2002-9, 11/25/02.
[29] 68 Fed. Reg. 6366 (2/17/03).

seek legal remedies against national banks. The OCC would limit state enforcement actions to the filing of declaratory judgment actions aimed at determining whether or not the state law in question is preempted. If, then, the court finds against preemption, the OCC maintains that enforcement of a bank's compliance with the state law "is within the OCC's exclusive purview."[30]

In the past, state Attorneys General have brought consumer law enforcement actions against national banks with little controversy, just as attorneys representing private individuals have filed suit to obtain legal redress against national banks.[31] The States have routinely investigated consumer complaints against national banks and have reached formal and informal settlements with national banks. Until recently, most national banks cooperated in the resolution of these actions, and the OCC voiced no disapproval of state enforcement efforts.

In some of these actions, the States were targeting fraudulent or deceptive practices by a local retail seller. To obtain adequate relief for victimized consumers, the States have included as defendants the banking institutions that provided the financing for the questionable transactions. As the West Virginia Supreme Court noted in allowing the state Attorney General to maintain an action against a national bank that financed the allegedly unlawful sale of motor vehicle extended warranties:

> Logic and experience dictate that if the types of lawsuits which the Attorney General could bring under the CCPA did not include lawsuits against financial institutions such as defendants, these institutions could, if unsavory, run in effect a "laundry" for "fly-by-night" retailers that seek to excessively charge their consumers. Consequently, the real meaning of consumer protection would be stripped of its efficacy.[32]

The OCC has increasingly hardened its position against state enforcement rights in the past three years. In 2001, the Minnesota Attorney General brought a federal court case against Fleet Mortgage Corporation under the FTC's Telemarketing Sales Rule[33] and the Minnesota Consumer Fraud Act. Minnesota alleged that Fleet Mortgage had engaged in a deceptive marketing scheme by providing customers' private account information to third party telemarketers selling memberships in buying clubs. Fleet also added the charges for the buying club sales to customers' mortgage loan accounts.[34]

Fleet Mortgage argued that only the OCC could enforce state consumer protection laws against it. The District Court rejected Fleet's motion to dismiss, holding that "[f]ederal law does not require that the OCC have exclusive enforcement over such actions. The OCC has no direct responsibility for enforcing non-banking state laws such as the [Minnesota consumer protection

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[30] Id. at 6370.

[31] See, e.g., State of Alaska v. First National Bank of Anchorage, 660 P.2d 406 (Alaska 1982); State of Arizona v. Serillo, 176 Ariz. 148, 859 P.2d 771 (1993); State of Wisconsin v. Ameritech Corp., 185 Wis. 2d 686, 517 N.W.2d 705 (1994); State of West Virginia v. Scott Runyan Pontiac-Buick, Inc., 194 W.Va. 770, 461 S.E.2d 516 (1995).

[32] State v. Scott Runvan Pontiac-Buick, Inc., supra, 461 S.E.2d at 526.

[33] 16 C.F.R. § 310 (promulgated pursuant to the federal Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. § 6101).

[34] State of Minnesota v. Fleet Mortgage Corp., 158 F. Supp. 2d 962 (D. Minn. 2001).

laws]." [35] Fleet, with the support of the OCC, brought a second motion to dismiss. The OCC, in its amicus brief, contended that neither Minnesota nor the FTC had any authority to enforce the Telemarketing Sales Rule against Fleet Mortgage because national banks are exempt from the Rule and the exempt status extended to non-bank subsidiaries like Fleet Mortgage. The District Court rejected the OCC's position: "The OCC's contention that it must have exclusive jurisdiction over subsidiaries in order to avoid having its authority 'restricted' is unpersuasive."[36]

There are other recent examples of States' consumer protection enforcement efforts against national banks, all of which the OCC would eliminate under its current preemption and visitorial powers stance. In some of these cases, the OCC has actively attempted to interfere with the state actions by advising banks that the States had no jurisdiction over them.

Beginning in 2001, a group of states, including California, Illinois, New York, and Florida, conducted an investigation into telemarketing operations by several major national banks. The banks had contracted with third-party telemarketers to share, for a fee, personal information about the banks' credit card customers and to provide access to bank customer billing information. The bank's name was then used in the telemarketer's sales pitch. The products sold were unrelated to the bank or to any banking services. The investigating states reached settlement agreements with Citibank and First USA despite the OCC's efforts to dissuade the banks from concluding such agreements. The OCC's view was that state Attorneys General had no enforcement authority over national banks.

In other recent examples, the Kentucky and Indiana Attorneys General have settled alleged violations of state "Do Not Call" telemarketing law violations with a national bank. The State of Arizona brought a case against an air conditioning company and Household Bank for alleged deceptive sales and financing practices targeting Spanish-speaking customers. In 2002, the States of Illinois, Maryland, and Missouri investigated an unlicensed trade school for deceptive advertising. The States questioned a national bank's role in financing tuition payments but were advised by the bank that they were preempted. The OCC confirmed the bank's view, and informed the States that the OCC alone would determine if there had been any violation of state consumer protection laws by the bank.

The proposed rule, when coupled with the OCC's pending proposed rule on visitorial powers and other OCC pronouncements, demonstrates that the OCC intends to divest the States of their traditional consumer protection enforcement jurisdiction over national banks.

D. The OCC's Proposed Rule and Other Recent Actions Undermine State Efforts to Attack Predatory Lending Abuses.

The OCC's recent preemption activity, including its order preempting Georgia's Fair Lending Law, is an unfortunate and unnecessary response to efforts by the States to control the problem of predatory mortgage lending. The States have taken a leadership role in addressing predatory lending, both in regulation and enforcement, and these state actions have been effective. The OCC should

[35] Id. at 966 (D. Minn. 2001).

[36] State of Minnesota v. Fleet Mortgage Corp., 181 F. Supp. 2d 995, 1001 (D. Minn. 2001).

recognize and support these efforts and seek to cooperate in achieving a shared goal of a fair lending marketplace.

Instead, as demonstrated by its order on the Georgia law, the OCC has found conflicts with the National Bank Act in virtually every statutory anti-predatory lending consumer protection adopted by the States. The OCC has also gone beyond assessing the impact of these laws on national banks, and has attacked the usefulness of these laws even as they apply to non-depository institutions.[37] If national banks are not subject to state laws, and if national banks are not the problem, as the OCC repeatedly asserts, then the OCC should have no reason to undermine the States' predatory lending initiatives.

The OCC's efforts to deal with the very substantial problem of predatory lending, while a step in the right direction, fall short of the actions taken by many states. In the proposed rule, the OCC takes a token and minimalist approach. The OCC's proposal addresses only asset-based lending, which is just one of the many abusive practices present in predatory lending. If the OCC intends to supplant all state laws governing predatory lending as to national banks, it should substitute a regulatory regime that more comprehensively addresses the unfair practices that are well-documented in this area. The OCC did begin to adopt a more broad based approach in Advisory Letter 2003-2, in which it recommended that banks adopt guidelines to prevent predatory lending practices. However, the OCC's general guidelines were merely advisory, intended to "encourage" national banks to adopt appropriate policies and do not carry the force of formal rules. The OCC should continue to build on the standards identified in AL 2003-2 and promulgate meaningful and specific predatory lending controls.

In every recent pronouncement the OCC has made on predatory lending, it has pointed out that a group of state Attorneys General are on record saying that most predatory lending problems have come from non-depository subprime mortgage lenders, not national banks. These statements by a group of Attorneys General were made in comments supporting a rulemaking proceeding by the Office of Thrift Supervision under the Alternative Mortgage Transaction Parity Act (AMTPA) and in an amicus brief filed in related litigation.[38] The Attorneys General supported the rational basis for OTS' distinction, in its revised AMTPA preemption rules, between "state housing creditors" and federally supervised banking institutions. The Attorneys General encouraged the OTS to revisit a prior preemption determination, and to require state housing creditors to comply with state laws regulating prepayment penalties and late fees.

It is true that most complaints and state enforcement actions involving mortgage lending practices have not been directed at banks. However, most major subprime mortgage lenders are now subsidiaries of bank holding companies (although not direct bank operating subsidiaries). Recent major settlements by state Attorneys General and the FTC related to alleged unfair lending practices by Household Finance and the Associates, both of which have now been acquired by bank holding companies. A national bank was a defendant in the only court case alleging class-wide

[37] *See* OCC News Release 2003-57 (7/24/03); OCC Working Paper, "Economic Issues in Predatory Lending," 7/30/03, available at: http://www.occ.treas.gov/workingpaper.pdf.

[38] National Home Equity Mortgage Association v. OTS, No. 02-2506 (GK) (D.D.C. 2003).

violations of North Carolina's Predatory Lending Act.[39] Several national banks have partnered with payday lenders for the sole purpose of claiming preemption authority to make very high rate, short-term consumer loans in violation of state laws. (The OCC took effective action to curtail this latter practice, known as "charter renting.") Based on these actions and other state consumer protection enforcement actions detailed above, it is clear that a national charter does not prevent a bank from engaging in unfair or deceptive practices.

State predatory lending laws have clearly identified unfair and deceptive lending practices and have imposed specific, appropriate requirements to protect consumers. The States that have enacted legislation have been sensitive to federalism concerns and have been careful not to impose direct restrictions on the rates and fees that nationally chartered lenders (or any lender) may charge. The objective in all states has been to narrowly target abusive practices and to cover only the more problematic reaches of the subprime marketplace, where borrowers are unsophisticated and where most of the problems have occurred.

Responsible lenders do not engage in the practices targeted by state predatory lending laws. These laws impose minimal burdens on legitimate lending institutions and do not impair any reasonable lending activity on the part of banks. The laws, by controlling the most abusive actors, serve to clean up the mortgage lending marketplace and restore consumer confidence, which benefits consumers and lenders alike.

In fact, many state predatory lending controls have now been voluntarily adopted by national subprime lenders. The prohibition on financing single premium credit insurance, which was considered controversial when it was included in North Carolina's 1999 law, has been accepted and implemented nationally by all of the major finance company mortgage lenders. The prohibition against flipping and the related "net tangible benefit" test, which was questioned by some lenders when it was introduced in North Carolina, also has been voluntarily adopted as a useful standard. Leading subprime lenders also have imposed restrictions on exorbitant points and origination fees, which were among the primary abuses identified in state predatory lending laws. Far from restricting the flow of credit, the predatory lending controls initially adopted by several states have become useful as bright line industry standards on a nationwide basis.

Despite the success and acceptance of state predatory lending laws, the OCC has declared every significant component of such laws to be impermissible burdens on national banks. In its order preempting the Georgia law, the OCC finds even the most non-controversial and widely accepted provisions to interfere with banks' ability to lend and therefore to be in conflict with the National Bank Act. As an example, no reasonable person would contend that encouraging a borrower to default on an existing loan is an acceptable lending practice. But just such a practice has been used by unscrupulous lenders or brokers to lead borrowers into a desperate delinquency situation, so that the borrowers then fall prey to whatever terms the lender dictates. Widely recognized as an unfair trade practice, encouraging default is prohibited by state predatory lending laws. Yet the OCC found this prohibition in the Georgia law to be preempted because it imposed

[39] Baxter v. Guaranty National Bank of Tallahassee, 01 CV 9168 (Wake County, NC Superior Court). The bank contended that the North Carolina law was preempted as to a national bank but the case was settled before this issue was judicially resolved.

impermissible restrictions on, and interfered with, "the exercise of the Federal power of national banks to make real estate loans."[40] The OCC also declared restrictions on other practices, such as negative amortization and financing of prepaid credit insurance premiums, and the requirement for high cost loan borrowers to receive credit counseling, to be similarly preempted.

If national banks do not routinely engage in practices such as encouraging default or using negative loan amortization, it is difficult to see how these consumer protections impede any bank's ability to lend. Yet under the proposed rule, any state law provision is preempted if it, among other things, 1) restricts a lender's ability to require insurance; 2) regulates anything relating to the terms of credit, including loan amortization or loan acceleration; 3) requires any disclosures; or 4) regulates advertising.

The OCC recognizes that national banks are subject to Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive trade practices.[41] Most states have similarly worded consumer protection statutes, many modeled on the FTC Act. If national banks are prohibited from engaging in unfair and deceptive practices under federal law, then it should be no impediment for them to comply with state laws proscribing the same unlawful practices. State predatory lending acts apply the States' unfair and deceptive practices regulatory authority to the field of mortgage lending. These statutes give further definition and more precise guidelines for lenders on fair conduct in making mortgage loans to consumers.

In the experience of the States, lenders welcome bright line tests more than general proscriptions against unfair conduct. However, in adopting its own very limited restrictions on predatory lending, the OCC falls back on compliance with the FTC Act as a standard for lenders to follow. The OCC would be better advised to fall back on the numerous state laws and regulations in this area and to develop more useful rules for the benefit of the banking industry and consumers alike. The OCC also should insist that national banks comply with state predatory lending laws unless there is compelling evidence that such compliance substantially interferes with a bank's ability to make real estate loans.

E. The OCC Has Exceeded its Authority in Extending Preemption Rights to the Operating Subsidiaries of National Banks.

The OCC's proposal to apply its overly broad preemption rules to operating subsidiaries of national banks clearly exceeds its authority under the National Bank Act. The proposal would do great damage to the state-federal dual banking system, and should be withdrawn.

Operating subsidiaries are not national banks subject to a national charter; they are state-created entities incorporated under state law and have been licensed and regulated by the States for years without controversy. Nothing in the NBA grants the OCC power to bar states from licensing, examining and otherwise regulating state-created non-bank entities that happen to be subsidiaries of national banks. Nevertheless, the OCC now proposes that operating subsidiaries of national banks should have the same legal and regulatory status as the national banks themselves, contending

[40] 68 Fed. Reg. 46278 (8/5/03).

[41] 15 U.S.C. § 45(a)(1).

that these subsidiaries are effectively departments, divisions or equivalent parts of the banks.

The OCC proposes to federalize state-chartered subsidiaries by placing them within the exclusive supervisory control of the OCC. Under the OCC's proposal, the States would be deprived of all authority to regulate these state-chartered corporations, which include mortgage companies that have long been licensed by States. The OCC proposal intrudes upon the States' sovereign powers and exceeds the boundaries of federal authority under the Tenth Amendment. It attempts to convert state-chartered corporations into creatures of federal law without permission of the chartering states.[42]

According to the OCC, a state law is exempted from preemption only if it is expressly incorporated into the federal banking laws or has no more than an "incidental" effect on banking activities. The OCC, however, considers mere inconvenience to a subsidiary of a national bank to be a conflict between federal and state law. As indicated by amicus curiae briefs filed by the OCC across the country, this overreaching standard would lead to the preemption of nearly all state licensing and regulatory laws. The preemption of state licensing laws, including the ability to license and examine mortgage lending entities, is not sound public policy. It would encourage financial institutions to give up their state charters, and to instead, seek either to obtain a federal charter or to merge with a national bank, effectively destroying the dual banking system that is valued by both Congress and the States.

Operating subsidiaries historically have been regulated by States under their respective laws and relevant regulatory regimes and are in no manner considered "national banks" by the NBA. Moreover, the NBA provides absolutely no basis for ignoring the corporate distinctions between a parent national bank and its subsidiary. In an area where, as here, state law traditionally has applied, Congressional intent to preempt state law must be clearly manifested.[43] There is no such intent expressed anywhere in the NBA, and the OCC's proposal is, in fact, contrary to Congressional intent, expressed most recently in the legislative history of the Riegle-Neal Interstate Banking Act.[44]

Additionally, the NBA provides stringent requirements for banks to qualify as national banks. None of these requirements apply to their state-chartered and state-regulated operating subsidiaries. Instead, as creatures of state law, operating subsidiaries should comply with applicable state law requirements.

Moreover, the States have long held an unquestioned primacy in regulating state-chartered corporations, particularly including companies that engage in consumer financial services. Courts have repeatedly upheld States' authority to exercise comprehensive supervision over the corporations they charter and to license and regulate corporations chartered by other states that transact business within their borders. As affirmed by the Supreme Court, "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations."[45] The

[42] Hopkins Federal Savings & Loan Ass'n v. Cleary, 296 U.S. 315 (1935).
[43] English v. General Electric Co., 496 U.S. 72, 74 (1990); California v. ARC American Corp., 490 U.S. 93, 101 (1989); Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977).
[44] See discussion in Section II.B. at pp. 4-5 above.
[45] CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 89 (1987).

fact that a state-chartered corporation is an affiliate of a national bank does not alter the principles of federalism that grant States the right to regulate corporations chartered under their laws. Indeed, in a case where the OCC similarly engaged in an overly aggressive interpretation by the OCC of the NBA, a federal circuit court of appeals concluded that "to defer to the OCC in this case would flout Congressional intent – something we remain unwilling to do."[46]

The OCC's claim of exclusive supervisory powers over operating subsidiaries is contrary to both this nation's dual system of banking and the historic primacy of the States in matters of corporate governance. The OCC's broad assertion of field preemption has no basis in any of the federal legislation that provide that agency with its regulatory authority. Like the OCC's claims of complete preemption with respect to national banks, the OCC's proposal to extend its hegemony to banks' operating subsidiaries wholly exceeds any reasonable interpretation of the regulatory powers given to the OCC by national banking laws. The OCC's proposal to create such a sweeping standard of preemption and to bar the States from regulating subsidiaries of national banks created under state laws directly violates Congressional intent, federal law and the Tenth Amendment to the Constitution.

In conclusion, the OCC's proposed rules represent a significant expansion of preemption standards and a restructuring of the federal-state balance that has existed for many years, particularly in the area of consumer protection. For the reasons expressed above, we urge the OCC to withdraw the proposed rules.

We thank you for the opportunity to submit these Comments. If you have questions or comments, please do not hesitate to contact Sarah Reznek, NAAG's Consumer Protection Project Director, at (202) 326-6016 or Blair Tinkle, NAAG's Legislative Director, at (202) 326-6258.

Respectfully,

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[46] American Land Title Association v. Clarke, 968 F.2d 150, 157 (2d Cir. 1992).

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STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS®

BEFORE
THE HOUSE FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

SUBMITTED BY
WALTER T. MCDONALD
PRESIDENT

JANUARY 28, 2004

On behalf of almost 1 million members of the NATIONAL ASSOCIATION OF REALTORS® I am submitting this statement in opposition to the Office of the Comptroller of the Currency (OCC) regulation that preempts state laws regarding real estate lending and other state consumer protection laws. This rule is another example of federal regulators run amok. It is clearly an effort to grant preferable treatment to national banks and their operating subsidiaries by misinterpreting existing law and mischaracterizing legal precedent. REALTORS® are greatly troubled by this turn of events. This action is bad for consumers, bad for homeowners, bad for small businesses, and bad for our members.

Many REALTORS® who operate mortgage, title, appraisal and other businesses are unfairly impacted by this unbridled grant of preemption for national banks and their subsidiaries. The OCC stated in its rule release that requiring state licenses could "create higher costs and operational burdens that banks either must shoulder, or pass onto consumers, or that may have the practical effect of driving them out of certain businesses." While it may require higher costs, those costs are shared by all businesses that operate within that state. Is it fair for national banks to be exempt? Has there been any indication that their profits have suffered due to previous compliance with these laws?

We fear this would only become worse if our efforts to prohibit the proposed real estate brokerage, leasing and management rule fail. If OCC logic prevails, it is not too much of a reach to conclude that the OCC would preempt state real estate licensing and continuing education requirements for national bank real estate operations. Is this what Congress intends?

The effort to concentrate banking regulation in the federal government should only be considered by *Congress* after a careful and complete examination determines that our nation's dual banking system has failed in some way. We believe our dual banking system continues to be the best in the world. It is a decentralized market that provides a stable supply of credit to every sector of our economy. As incubators of new and innovative products state banks help REALTORS® put American consumers in homes. The dual banking system requires state regulators who are closer to consumers to provide remedies to those who are injured by the acts of financial institutions. Even if the OCC has the desire, does it have the resources to effectively protect consumers in every state, city and neighborhood where national banks do business?

The OCC has consistently relied on the broadest misinterpretation of the law to determine that national banks may avoid state consumer protection, insurance and lending laws due to their federal charter. Congressional intent is unclear, and the OCC currently is taking advantage of this lack of clarity. Nevertheless, Congress has repeatedly upheld the dual banking system and limited the authority of the OCC to preempt state laws. In our legal analysis attached to this statement we detail Congressional actions and the court cases applicable to this issue.

Are we to believe that Civil War necessities should apply to our modern banking system, as the OCC implies in its citing of preemptive authority? Surely, none of these existing consumer protection and licensing statutes threaten to destroy any national bank today.

This rule follows a predictable pattern of national banks working with their regulator, the OCC, to gain greater market share and an expanded portfolio. Their efforts in the early 1990's to obtain broad insurance powers are illustrative. These efforts led to the *Barnett* case.

The applicable language granting authority to the OCC to preempt state laws found in *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996) holds that states cannot "forbid, or (to) impair significantly, the exercise of a power that Congress explicitly granted. To say this is not to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank's exercise of its powers." The Court continued by citing three supporting cases where the Court held certain state laws did not "unlawfully encroach,"[1] would not "destro[y] or hampe[r]"[2] and do not "interfere with, or impair"[3] national banks' functions, rights or privileges.

It was only after the conclusion of this case that national banks redoubled their efforts to obtain legislative authority to broadly operate securities and insurance businesses. They were finally successful with the Gramm/Leach/Bliley Act that spelled out how they could enter these businesses.

After Congress carefully crafted language that codified the *Barnett* decision, the OCC and its partner banks continued to push the envelope. Congress relied on the language that states could not "prevent or significantly interfere with the national bank's exercise of its powers" in Section 104(d)2 of the Gramm/Leach/Bliley Act. Although Congress never indicated any other standard would be appropriate for determining preemption of state laws, the OCC relied on different language from Barnett to support its preemption of state consumer protection, insurance and lending laws.

The OCC continues to twist the law to meet its ends. NAR believes those ends are to increase the value of the federal charter at the expense of state licensing and consumer protection measures. As an agency whose very existence depends on the assessments that its member banks render, it is in the OCC's best interest to promote the healthiest and most profitable institutions it can. That is an admirable goal that produces safe and sound national banks. But that promotion should not become so relentless that it crosses the line to unfairly prejudice other institutions not under the auspices of the OCC.

NAR has consistently argued that Congress must not allow unelected regulators to unfettered interpretation and enforcement of all laws as they see fit. There is just not enough attention paid by these agencies to public comment or Congressional opposition. Although some leeway must be granted to regulators to fashion the most effective regulation, recent actions prove that some Congressional contraction of authority is necessary.

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[1] *Anderson Nat. Bank* v. *Luckett*, 321 U.S. 233, 247-252 (1944) (state statute administering abandoned deposit accounts did not "unlawful[ly] encroac[h] on the rights and privileges of national banks.").
[2] *McClellan* v. *Chipman*, 164 U.S. 347, 358 (1896) (application to national banks of state statute forbidding certain real estate transfers by insolvent transferees would not "destro[y] or hampe[r]" national banks' functions).
[3] *National Bank v. Commonwealth*, 76 U.S. 353, 362 (1870) (national banks subject to state law that does not "interfere with, or impair [national banks'] efficiency in performing the functions by which they are designed to serve [the Federal] Government.").

Even Chairman Oxley questioned the OCC's preemption efforts to overrule the Massachusetts Consumer Protection Act. (Oxley letter to Treasury Secretary O'Neill, April 22, 2002) In that letter, Chairman Oxley quotes the GLBA conference report "explicitly states that it was 'recognizing the primacy and legal authority of the States to regulate insurance activities of all persons.' " The OCC seems to have no trouble ignoring specific legislative language or intent in the area of insurance activities.

The OCC should not have the ability to determine the winners and losers in a marketplace through broad preemption of state laws for national banks. All other national and local businesses continue to meet the regulatory burden of complying with the laws that protect this country's consumers against all but national banks and their subsidiaries. There is no valid public policy to create such a special class of financial services company.

No other federal regulator has been as callous in its disregard for consumer protections, and no other regulator has so fiercely fought against a dual regulatory system in this country. The Securities and Exchange Commission and the states both enforce consumer protections and securities laws over this industry. The Food and Drug Administration's whole purpose is to protect Americans. It does so in cooperation with state health authorities. The Federal Trade Commission operates closely with state officials and does not attempt to circumvent state unfair and deceptive trade practices laws.

The OCC has historically argued that consumers and businesses can "take their business elsewhere" if they don't like how national banks operate. This "free market rhetoric" loses quite a bit of strength when one considers how only a few huge banks are coming to dominate that market. The opportunities to utilize other businesses are shrinking due to the constant grant of special privileges to national banks. This latest salvo could destroy the dual banking system, leading to an oligopoly of huge multinational banks that can disregard state licensing and consumer protection laws. This situation would certainly lead to eventual problems that Congress would need to rectify. They should address the situation now before the problems occur.

The consolidation of so many financial institutions into only a few huge banking conglomerates has troubled REALTORS® for some time now. Our concern is only heightened when an out of control regulator can finalize rules like this over the objection of businesses, consumers, states, and many Members of Congress.

Congress should not let this situation continue. Congress needs to rein in the regulators before these actions lead to untenable consequences.

Maybe it is time for Congress to amend the Civil War era National Bank Act to make it abundantly clear that state consumer protection and licensing laws apply to national banks and their operating subsidiaries, and to prohibit the OCC from unilaterally preempting these laws unless they truly discriminate against them.

REALTORS® stand ready to support such efforts and we appreciate your attention to this issue.

NAR Challenges OCC's Power to Preempt State Real Estate Lending and Licensing Laws

- The language of the National Bank Act does not express Congress' intent that the OCC has the authority to preempt state real estate lending or licensing laws.

- Courts have not interpreted the National Bank Act as granting the OCC broad authority to preempt state real estate lending or licensing laws.

The NATIONAL ASSOCIATION OF REALTORS® (NAR) is America's largest trade association, representing almost 1 million members who are very concerned about the negative impact that preempting state real estate lending and licensing laws will have on consumers, homeownership and the real estate industry. REALTORS® are engaged in all aspects of the real estate industry – commercial and residential brokerage, property management, investment, development – in the United States and internationally.

NAR is troubled by the Office of the Comptroller's (OCC) final rule amending amend parts 7 – Bank Activities and Operations –and 34 – Real Estate Lending and Appraisals (particularly § 34.4 (1), "licensing, registration, filings, or reports by creditors") of its regulations to expand the types of state laws that are preempted. As discussed more fully below, NAR disagrees with the OCC's interpretation that federal law enables the agency to issue broad preemption regulations for national banks' real estate lending activities and opposes the agency's final rule.

I. Supremacy Clause and General Principles of Preemption

It is well recognized that the foundation of federal preemption is rooted in paragraph 2, Article VI of the U.S. Constitution, Supremacy Clause, "[the] Constitution and the laws of the United States . . . shall be the supreme law of the land . . . anything in the constitutions or laws of any State to the contrary notwithstanding." In the absence of express preemption (where Congress has expressly stated that it intends to preempt state law), courts look for implied preemption in two forms:

- That the federal government so occupies the field in a given area that there is no room for the state to participate in regulation; and
- That state law actually conflicts with federal law.[4]

NAR strongly maintains that the OCC has not met either standard of federal preemption in the area of real estate lending license laws and thus, should articulate in the final rule that such laws are not preempted.

II. The OCC Does Not Have Congressional Authority to Preempt All State Laws Related to Real Estate Lending.

[4] *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947) and *Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta*, 458 U.S. 141, 152 (1982).

A. The OCC's power to make a broad preemption assertion is belied by its prior recognition of its limited pre-emptive authority.

Congress enacted the National Currency Act in 1863 (NCA) and amended it one-year later with the National Bank Act (NBA) in order to help bring stability to the economy during the Civil War. It was the intent of Congress at the time to replace the existing system of state banks with one national banking system. Representative Hooper, speaking in support of the measure, indicated the need for amending the National Currency Act after only one year was, "to render the law so perfect that the State banks may be induced to organize under it, in preference to continuing under their State charter."[5]

Congress' action to give national banks paramount powers was solely for the purpose of putting state banks out of business. Much to the dismay of the proponents of the 1864 NBA, state banks were not "induced" to convert their charter. Today our dual banking system is habitually reviewed and ultimately preserved by congressional action. It is also important to note that the NBA did not give national banks authority to lend on the security of real estate.

It was not until 1913 when Congress enacted the Federal Reserve Act that national banks were allowed to conduct real estate lending activities. However the legislative provisions governing real estate lending were very limiting, i.e., aggregate lending limits, geographic limits, and limits on loan terms and conditions.[6] In 1982, Congress overhauled banks' real estate lending activities by removing what was referred to as "rigid statutory limitations"[7] in favor of allowing national banks to "make, arrange, purchase, or sell loans or extensions of credit secured by liens on interest in real estate, subject to such terms, conditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation."[8]

Congress stated that the purpose for the 1982 action was "to provide national banks with the ability to engage in more creative, flexible financing, and to become stronger participants in the home financing markets."[9] Congress could have easily stated their intent with the Garn-St. Germain Depository Institutions Act of 1982 was that federal law preempts state real estate lending laws, but it did not. Instead, use of "stronger participant" directly implies Congress' recognition that national banks are players among many in real estate lending – there is no single regulator.

Shortly after enactment of the Garn-St. Germain Depository Institutions Act, the OCC promulgated the implementing real estate lending regulations (part 34) and detailed certain standards for such activities. The OCC's standardizing regulations indicate that national banks may make real estate secured loans without regard to state laws that limit:

- The amount of the loan in relation to the appraised value;
- The schedule for repayment of principle and interest;

[5] Cong. Globe, 38th Cong., 1st Sess. 1256 (March 24, 1864).
[6] Federal Reserve Act, ch. 6, § 24, 38 Stat. 251 (1913).
[7] S. Rep. No. 97-536, at 27 (1982).
[8] Garn-St. Germain Depository Institutions Act of 1982, Pub. L. 97-320, § 403, Stat. 1469 (1982).
[9] S. Rep. No. 97-536, at 27 (1982).

- The term to maturity of the loan;
- The aggregate amount of funds which may be loaned; and
- The restrictions that must be contained in a lease to qualify the leasehold as acceptable security.

When the OCC promulgated these regulations it stated its intent in preempting state laws where the Garn-St. Germain Depository Institutions Act removed such limitations, was "to preclude any conflict of state law with Congressional intent . . ."[10] Furthermore, the OCC noted:

> The final rule clarifies the limited scope of the preemption. Aside from the specific preemption of state law as to the restrictions discussed, the relationship between state and federal law in regard to real estate loans as it existed prior to the [Garn-St. Germain Depository Institutions Act] amendment is expected to remain unchanged.[11]

The OCC's last review of part 34 prior to the rule proposal currently at issue occurred in 1996. The OCC removed a provision from its real estate lending standards that stated "national banks must comply with all applicable federal laws and regulations, including those pertaining to disclosures."[12] In its place, the OCC added the following language: "The OCC will apply recognized principles of Federal preemption in considering whether State laws apply to other aspects of real estate lending by national banks."[13]

In 1999, the Government Accounting Office (GAO) examined the role of OTS and OCC in the preemption of state law. Their report articulated that from the authority in Home Owners Loan Act, the OTS 1996 preemption rules are based on a finding that Congress intended the agency to occupy the field of regulation.[14] The GAO also reported that the OCC relies on conflict preemption – not field preemption – when issuing interpretations of whether federal law preempts state law.[15] More importantly, the report stated:

> While the statutory authorities OTS and OCC use to formulate the preemption opinions are different, their approaches share a common feature. Both agencies rely on past court decisions to guide their analysis of whether a federal law or regulation preempts state law.[16]

To reiterate, the OCC has not relied on field preemption in the area of real estate lending, and instead has relied on court decisions to guide their formulation of preemption decisions. Interestingly enough, the majority of court cases reviewing federal preemption of state law have not had to address field preemption because they usually find actual conflict. To date, there have

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[10] 48 Fed. Reg. 40698-40701 (September 9, 1983).
[11] Id. at 40699 (emphasis added).
[12] 12 C.F.R. § 34.2(b).
[13] 12 C.F.R. § 34.4(b). The OCC's 1996 rulemaking also revised the numbering of part 34 – § 34.2 became § 34.4.
[14] GAO Report, *Role of the Office of Thrift Supervision and Office of the Comptroller of the Currency in the Preemption of State Law*, B-284372 at 2,4 (February 7, 2000).
[15] Id. at 2.
[16] GAO Report at 7 (emphasis added).

been no Supreme Court opinions that ruled on whether OTS or OCC reliance on field preemption in the area of real estate lending is appropriate.

B. Congress and the statutory legislative scheme reveal no intention or authority for the OCC to issue broad preemption regulations.

It is well established that, in absence of express legislation conveying congressional intent to supercede state law, that the following tests are used to detect field preemption: 1) "[the] scheme of federal regulation may be so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it;" 2) "[the] Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject;" or 3) "the object sought to be obtained by the federal law and the character of obligations imposed by it may reveal the same purpose."[17]

Pervasiveness

In gathering evidence as to whether or not pervasiveness exists to imply broad preemption authority, courts consider language of the legislation, regulations promulgated pursuant to the legislation and the legislative history. Since *Rice v. Santa Fe Elevator Corp.* was decided in 1947, the Supreme Court has only on a few occasions found a scheme of regulation so pervasive as to determine field occupation.[18] "In contrast, the Supreme Court has rejected field preemption claims in areas of obvious federal interests such as . . . due-on-sale clauses in mortgages and the entire field of federal savings and loan regulation . . . and standards for officers and directors of federally insured banking institutions."[19]

Dominant Federal Interest

As stated above, the second test that courts have accepted as evidencing intent to supercede state law is dominance of federal interest. In making a dominance determination, courts have weighed whether the legislation or regulation is "so intimately blended and intertwined with responsibilities of the national government that where it acts, and the state also acts on the same subject, 'the act of congress (sic) . . . is supreme.'"[20] Traditionally, dominant federal interest has been reserved for areas of national security, defense and treaties. The courts, however, have eagerly pointed out their apprehension in making such a determination of dominant federal interest by noting "[u]ndoubtedly, every subject that merits congressional legislation is, by definition, a subject of national concern. That cannot mean, however, that every federal statute ousts all related state law."[21]

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[17] *Fidelity Fed. Sav., supra*, at 153, quoting *Rice, supra*, at 230.
[18] John Duncan, *The Course of Federal Preemption of State Banking Law*, 18 Ann. Rev. Banking L. 221, 232 (March 1999). Example of findings of pervasiveness include interstate sale of natural gas, American Indian affairs, airport noise pollution, etc. Id. at 233.
[19] Id. 233. The Court in *Fidelity Fed. Sav.* noted "[b]ecause we find an actual conflict between federal and state law, we need not decide whether the HOLA or the Board's regulations occupy the field of due-on-sale law or the entire field of federal savings and loan regulation." *Fidelity Fed. Sav., supra*, at 158 n. 14.
[20] *Hines v. Davidowitz*, 312 U.S. 52, 66 (1941), quoting in part *Gibbons v. Ogden*, 9 Wheat. 1, 211 (1824).
[21] *Hillsborough County v. Automated Med. Labs., Inc.*, 471 U.S. 707, 719 (1985).

In 1985, the Supreme Court was asked to consider whether two local ordinances that required blood donors be tested for hepatitis and alcohol content were preempted by federal regulation. The Court recognized the validity of the Food and Drug Administration's broad regulations establishing standards for the collection of blood, however, it opined,

> To infer preemption whenever an agency deals with a problem comprehensively is virtually tantamount to saying that whenever a federal agency decides to step into a field, its regulations will be exclusive. Such a rule, of course, would be inconsistent with the federal-state balance embodied in our Supremacy Clause jurisprudence.[22]

The OCC maintains that Congress has "expressly and exclusively" referred to the Comptroller as "the entity possessing authority to set restrictions and requirements that apply to national banks' real estate lending activities."[23] Furthermore, the OCC contends that "national bank real estate authority has been extensively regulated at the [f]ederal level since the power first was codified." The NAR believes the OCC is mischaracterizing the congressional intent as it relates to real estate lending; in fact, there is little evidence of pervasiveness or dominance to imply exclusive authority to regulate real estate lending activities.

To be sure, certain aspects of real estate lending are, to a limited extent, addressed by federal law in a manner that infers a design to occupy a narrow field.[24] These primarily include the standards for real estate lending that the OCC promulgated in 1982, which went virtually unchanged when the OCC opened up part 34 to review in 1995-96 (loan to volume limits, repayment schedule, loan term, total amount of funds which can be loaned and qualifying leasehold as security). But even these were implemented pursuant to 1982 standardizing regulations that were as a direct result of congressional action easing real estate lending restrictions. The OCC could not act in such a way on its own. In contrast, there is presently no recently enacted federal legislation relating to real estate lending that requires implementing regulations that would suggest a similar intent that the OCC preempt even a narrow field.

In short, preemption of state licensing requirements related to real estate lending is wholly inappropriate on the basis of lack of congressional intent.

- Congress has not exercised federal authority in the area of real estate lending licenses, nor has it directed any banking agency to regulate licensing with such a complete scheme that leaves no room for states to supplement. This is further evidenced by the fact that on a number of occasions, Congress carved out certain real estate lending related licenses from federal legislation and specifically recognized state regulation.[25]

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[22] Id. at 717.
[23] 68 Fed. Reg. 46124 (August 5, 2003).
[24] Duncan, 312.
[25] The Gramm-Leach-Bliley Act expressly provides for compliance with state insurance licensing laws, "[n]o person shall engage in the business of insurance in a State as principal or agent unless such person is licensed as required by the appropriate insurance regulator of such State in accordance with the relevant State insurance law." 15 U.S.C. 6701 (2000). The Financial Institutions Reform, Recovery and Enforcement Act recognizes state appraisal licenses and requires use of certified and licensed appraisers in federally related transactions. 12 U.S.C. 3336 (2000).

- Factors indicating dominant federal interest in real estate lending licenses are conspicuously absent. The federal government has not exerted power in the real estate licensing arena; and
- The object sought to be obtained by the National Bank Act and the character of obligations imposed do not reveal a purpose to preclude enforcement of state real estate lending license laws.

Finally, a further dramatic illustration of the absence of any intent by Congress to empower the OCC with exclusive preemption authority is the open criticism of the agency's preemption activities during consideration of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal). The House conferees recognized that:

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdiction, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses and communities.[26]

The Riegle-Neal conferees further stated:

> Federal banking agencies have applied traditional preemption principles in a manner the Conferees believe is inappropriately aggressive, resulting in preemption of State law in situations where the federal interest did not warrant that result.[27]

And finally, the only banking regulator that the Riegle-Neal conferees singled out as "inappropriately aggressive" was the OCC.[28]

III. Conflict Preemption is Inapplicable Because State Real Estate Lending License Laws Do Not Conflict with Federal Law

The OCC generally relies on conflict preemption when issuing interpretations of whether federal laws preempt specific state law. Their analysis in making such a determination is usually guided by past court decisions.[29] The NAR asserts that real estate lending license laws do not conflict with federal law on the simplest grounds –there can be no conflict where there is no governing federal law.

In determining whether conflict is present in a state law that ultimately warrants federal preemption, the Courts consider two factors: that compliance with both the federal law and the

[26] H.R. Conf. Rep. No. 103-651, at 53 (1994).
[27] Id. (emphasis added).
[28] Id. The Conference Report specifically cited the OCC's preemption of the New Jersey Consumer Checking Account Act and the OCC's interpretive rule at 12 C.F.R. 7.8000, preempting any State law that attempts to prohibit, limit, or restrict deposit account service charges. The conferees urged the OCC to reconsider both these preemption interpretations.
[29] GAO Report, 6.

state law is a "physical impossibility;"[30] or when "the state law stand[s] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[31]

"Physical Impossibility"

First and foremost, it is essential that the OCC recognize that real estate lending licenses go far beyond mortgage banker and mortgage lender licenses; the term "license" in the context of real estate lending covers in various jurisdictions almost every real estate lending related service that touches on the transaction including, but not limited to: mortgage brokerage, insurance, title service, appraiser, home inspector, legal services, termite/insect inspector, surveyor and escrow agent.

All of these real estate related services are licensed at the state level and in most cases, are essential to the completion of the real estate loan transaction. Currently, there is no federal statute codifying national standards for real estate lending service professionals. In fact, on more than one occasion, Congress has specifically directed regulatory agencies to recognize state licensing laws.[32]

The Supreme Court has on a number of occasions found conflict when presented with a federal preemption question. However, the Court has emphasized that under conflict preemption principles, a state law is not preempted if the regulated party can comply with both the state and federal regulation.[33]

In 2002, the Federal Trade Commission (FTC) was asked to consider whether or not Connecticut's financial privacy law is preempted where compliance with both the state privacy law and provisions of Gramm-Leach-Bliley Act appear physically impossible. The FTC determined:

> [W]here Connecticut law prohibits disclosure and federal law permits disclosure, a Connecticut financial institution can comply with both laws by not disclosing the consumer's nonpublic personal information. Likewise, where federal law prohibits disclosure and state law permits disclosure, the financial institution can comply with both laws by not disclosing the information. Here, compliance by Connecticut financial institutions with both the federal and state requirements is not physically impossible.[34]

The FTC bases its Connecticut rationale on standards set in *Pacific Gas & Elect. Co. v. State Energy Resources Conservation & Dev. Comm'n* stating, "if a state law prohibits what federal law merely permits but does not require, compliance with both statutes is possible."[35]

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[30] *Barnett Bank of Marion County v. Nelson*, 517 U.S. 25, 31 (1996), quoting *Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-143 (1963).
[31] Id., quoting *Hines, supra,* at 67.
[32] *See, e.g.* footnote 23.
[33] *See, Hillsborough, supra* at 722.
[34] Letter of June 7, 2000 from FTC to Connecticut Banking Commissioner.
[35] Id. quoting *Pacific Gas & Elect. Co. v. State Energy Resources Conservation & Dev. Comm'n*, 461 U.S. 190, 218-219 (1983).

Hence, where a state law prohibits engaging in real estate lending activities without a license and federal law is silent, one simply cannot maintain that simultaneous compliance is physically impossible. The notion of conflict requires a determination that there is an "inevitable collision between the [state and federal] schemes of regulation."[36] Simply put, it takes two laws – state and federal – for a collision. State real estate lending license laws have nothing to collide with at the federal level and should not be preempted.

"Stands as an Obstacle"

The *Hines* Court established the second standard of conflict preemption – that "the state law stand[s] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[37] The OCC on a number of occasions has used the *Barnett* decision in its rational for preemption determinations, including two such decisions involving state occupation/ professional license laws.[38] Specifically, the OCC holds the following *Barnett* excerpt as the agency's effigy for "stands as obstacle" –

> In defining the pre-emptive scope of statutes and regulations granting a power to national banks, these cases [i.e. national bank preemption cases] take the view that *normally* Congress would not want States to forbid, or to impair significantly, the exercise of a *power that Congress explicitly granted.* To say this is not to deprive States of the power to regulate national banks, where . . . doing so does not prevent or significantly interfere with the national bank's exercise of its powers.[39]

The *Barnett* Court drew attention to the latter part of the above statement (i.e., [t]o say this is not to deprive States . . .) by citing three supporting cases where the Court held certain state laws did not "unlawfully encroach,"[40] would not "destro[y] or hampe[r]"[41] and do not "interfere with, or impair"[42] national banks' functions, rights or privileges.

In the same preemption decisions involving state occupation/professional license laws, the OCC further maintains that the *Barnett* Court finds preemption of state laws that condition the exercise of national bank powers. Specifically, the OCC states:

[36] *Florida Lime & Avocado Growers, supr,* at 143.
[37] *Hines, supra,* at 67.
[38] 65 Fed. Reg. 15037-15041 (March 20, 2000) and 66 Fed. Reg. 23977-23979 (May 10, 2001). In addition to these two Preemption Determinations, the OCC frequently cites *Barnett* in other publications such as congressional testimony, amicus briefs, advisories and public speeches.
[39] Id. at 33 (emphasis added).
[40] *Anderson Nat. Bank* v. *Luckett*, 321 U.S. 233, 247-252 (1944) (state statute administering abandoned deposit accounts did not "unlawful[ly] encroac[h] on the rights and privileges of national banks.").
[41] *McClellan* v. *Chipman*, 164 U.S. 347, 358 (1896) (application to national banks of state statute forbidding certain real estate transfers by insolvent transferees would not "destro[y] or hampe[r]" national banks' functions).
[42] *National Bank v. Commonwealth*, 76 U.S. 353, 362 (1870) (national banks subject to state law that does not "interfere with, or impair [national banks'] efficiency in performing the functions by which they are designed to serve [the Federal] Government.").

> [W]here Congress has not expressly conditioned the grant of "power" upon a grant of state permission, the Court has ordinarily found that no such condition applies. In *Franklin Nat. Bank*, the Court made this point explicit. It held that Congress did not intend to subject national banks' power to local restrictions, because the federal power-granting statute there in question contained "no indication that Congress [so] intended . . . as it has done by express language (sic) in several other instances."[43]

What the OCC has neglected to refer to when citing the above *Barnett* passage is the *Franklin* Court's note that "[e]ven in the absence of such express language, national banks may be subject to some state laws in the normal course of business if there is no conflict with federal law."[44]

Objectives of Congress – Real Estate Lending

Congressional intent, it can be argued, is in the eye of the beholder. This is especially true for statutes codified in the early history of our nation and that have been subsequently amended to accommodate evolving public interests. When presented with a preemption question as to whether a state law "stands as an obstacle," courts "[e]xamine the explicit statutory language and the structure and purpose of the statute."[45]

In the case of national banks' real estate lending activities, it is erroneous for the OCC to rely on the original congressional purpose of the National Bank Act when the Act did not even address such lending powers. Instead, it is more relevant to closely examine Congress' objectives when real estate lending powers were first authorized for national banks in 1913, together with Congress' objectives when the banking system was overhauled in 1982.[46] The Federal Reserve Act was enacted to bring stability and integrity to the nation's financial system and to establish a more effective supervision of banking.[47] The objective of Garn-St. Germain was to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans.[48]

Congress attempted to achieve the objective of Garn-St. Germain by easing "rigid statutory limitations."[49] However, Congress was not referring to state imposed "rigid statutory limitations," instead Congress was referring to its self-imposed federal limitations on real estate lending activities.

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[43] *Barnett, supra* at 34. 65 Fed. Reg. 15037-15041 (March 20, 2000) and 66 Fed. Reg. 23977-23979 (May 10, 2001).
[44] *Franklin National Bank v. New York*, 347 U.S. 373, 378 n. 7(1954) citing *Anderson, supra* and *McClellan, supra.* (emphasis added).
[45] *Gade v. National Solid Wastes Management Ass'n*, 505 U.S. 88, 96 (1992) quoting *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 138 (1990).
[46] *Federal Reserve Act*, ch. 6, § 24, 38 Stat. 251 (1913) and *Garn-St. Germain Depository Institutions Act of 1982*, Pub. L. 97-320, § 403, Stat. 1469 (1982).
[47] Testimony of the Vice Chairman of the Board of Governors of the US Federal Reserve System, Ms. Alice M. Rivlin, before the Committee on Banking and Financial Services of the US House of Representatives on July 29, 1997.
[48] S. Conf. Rep. No. 97-536, at 27 (1982).
[49] Id.

Thus, when considering whether or not state real estate lending license laws "stand as an obstacle" to Congress' objectives in legislating national banks' real estate lending activities, one must ask,

- Do state real estate lending license laws impede the stability, integrity or supervision of national banks?
- Do state real estate lending license laws interfere with or weaken the mortgage lending market?

NAR maintains that the answer to both of these questions is a resounding "No" – there is no impediment and there is no interference with the intent of federal law governing real estate lending.

IV. State Real Estate Lending License Laws May Not be Preempted Because They Do Not Discriminate Against National Banks

Traditionally, courts will find that a state law is not preempted as long as it does not discriminate by imposing disproportionate restrictions. One of the earliest cases on this point is *Davis v. Elmira Savings Bank* where the Court stated:

> Nothing of course . . . is intended to deny the operation of general and undiscriminating state laws on the contracts of national banks, so long as such laws do not conflict with the letter or the general objects and purposes of Congressional legislation.[50]

Recently, a California court was asked to consider a federal preemption claim by a savings and loan association (regulated by the OTS and governed by Home Owners' Loan Act). The court, when analyzing the applicability of implied preemption held:

> The duties [of California's unfair competition law] govern, not simply the lending business, but anyone engaged in any business and anyone contracting with anyone else. On their face, [the state law] do[es] not purport to regulate federal savings associations and are not specifically directed toward them. Nor is there any evidence that they were designed to regulate federal savings associations more than any other type of business, or that in practice they have a disproportionate impact on lending institutions.[51]

It is notable that there are license requirements for a number of the services involved in the real estate lending context that are imposed primarily for consumer and public interest protection purposes. Most state statutes regarding occupational licenses fall within the "business and professional" section of the governing code. Except for mortgage lender/broker, licenses for real estate related service professionals (insurance, title service, appraiser, home inspector, legal

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[50] *Davis v. Elmira Sav. Bank*, 161 U.S. 275, 290 (1896), see also *First Nat'l Bank of San Jose v. California*, 262 U.S. 368, 369 (1923).
[51] *Gibson v. World Sav. & Loan Ass'n*, Cal. App. 4th 1291, 1302 (2002).

service, termite/insect inspector, surveyor, escrow agent, etc.) are not considered "lending regulations," and apply equally and in some cases predominantly in other transactions.

Thus, there is no discrimination against national banks, and thus no implied preemption under the *Gibson* rationale, because:

- Real estate lending license laws are not solely applicable to the banking business, but to anyone who is engaged in the real estate services industry;
- Real estate lending license laws are not specifically directed toward national banks;
- There is no evidence that real estate lending license laws were designed to regulate national banks more than any other type of business; and
- There is no evidence that real estate lending license laws have a disproportionate impact on national banks.

V. Conclusion

In the OCC's material accompanying its Final Rule, the agency asserted,

> Preemption of state laws governing national banks' real estate lending certainly *does not* [sic] mean that such lending would be unregulated. On the contrary, national banks' real estate lending is highly regulated under federal standards and subject to comprehensive supervision.[52]

While NAR agrees with the OCC that their regulatory enforcement in certain areas of real estate lending has helped to protect consumers, we maintain that these are congressionally prescribed supervisory standards. The OCC has taken positive steps in the areas of combating predatory lending, reining in banks that partner with payday lenders and working with community organizations to promote consumer education.

However, NAR believes the current standards for applicability of state law detailed in the OCC regulations (12 C.F.R. § 34.4) are as far as the agency can go without an act of Congress clarifying their explicit intent to preempt state real estate lending laws.

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[52] OCC *Question and Answers* for Final Rule 12 CFR Parts 7 ans 34 Bank Activities and Operations; Real Estate Lending Activities, http://www.occ.treas.gov/2004-3dPreemptionQNAs.pdf.

CONGRESSIONAL REVIEW OF OCC PREEMPTION (12 CFR, 7 AND 34)

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
HOUSE COMMITTEE ON FINANCIAL SERVICES

TESTIMONY
OF
LORRIE KEATING HEINEMANN, SECRETARY
WISCONSIN DEPARTMENT OF FINANCIAL INSTITUTIONS,
JANUARY 28, 2004

Thank you for the opportunity to present the Wisconsin Department of Financial Institutions opposition to the OCC's blanket preemption attempt in 12 CFR Parts 7 and 34. We are in good company in our opposition as we are joined by the 49 state banking regulators, the National Governors Association, the National Association of Attorneys General and the North American Securities Administrators Association, among many others. The sweeping, unilateral preemption by the OCC is a threat to consumer protection, the dual-banking system and an affront to the democratic principle of states' rights.

This rule promulgation raises public policy questions of whether one federal regulatory agency can and should be preempting laws that were lawfully enacted by our state legislature to protect our citizens. We cannot implement gratuitous regulations at the state level because, unlike the process for adoption of the OCC rule, the statutes from which we regulate are debated in public hearings and passed in our State Legislature, a body made up of locally elected officials. The OCC rule takes great power away from the democratic process that occurs at the state level.

This rule prevents state regulators from enforcing consumer protection laws against subsidiaries of national banks. Entities like finance companies, mortgage companies and check cashing companies, just to name a few, are subject to state regulations. If these companies are organized as subsidiaries of national banks, the OCC rule sweeps away virtually all consumer protection laws. Predatory lending is one area that is taking a toll on our communities. We need to have an ability to address this at a local level for the financial strength of our citizens. Also, the scandals and consumer abuses exposed by the state regulators in the mutual fund industry provides a recent example of how a single regulator from Washington D.C. cannot and should not be the only regulator of our financial markets.

Furthermore, extensive preemption of state laws and state oversight threatens to undermine the integrity of the dual banking system and moves towards a centralized regulatory model that severely weakens the ability of states to respond to local

economic needs. Charter choice for banks serves as an important check and balance system that ensures the regulatory approaches at both the state and federal levels are reasonable. The strength of the dual banking system should not be jeopardized in favor of a unilaterally imposed rule that would tilt the critical balance to federalization. The contributions that the dual banking system has made to the strength and resilience of our economy are well documented. If other developed countries with centralized banking systems are to provide an example, this could be to the detriment of community banking, small businesses, the consumer and the economy.

To summarize, Wisconsin urges you to take action and prevent this abuse of power by the OCC. This rule has a negative impact on consumer protection, negative implications for the duel banking system and is an assault on the powers of states.

O